FINAL REPORT

Impact of Trade and Economic Policy Reforms on Key Sectors of the Egyptian Economy

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Executive Summary

Egypt has undertaken substantial economic policy reforms in the past few years. It has achieved macroeconomic stability by reducing fiscal deficits, slowing the growth of money and credit, lowering the rate of inflation, and reducing interest rates. It has also devalued its currency and freed up the exchange rate. Trade policy reform has eliminated most quantitative restrictions, lowered tariff rates, and made tariff rates more uniform across product lines. Some of these reforms have been unilateral and others have been linked to commitments Egypt made as member of the World Trade Organization (WTO). As a result exports other than petroleum more than doubled from 1995/96 to 2002/03. Numerous business leaders also report that exports increased markedly after devaluation in early 2003. Sectors experiencing rapid export growth include fresh horticultural crops, processed foods, cotton lint and yarn, garments, marble, and ceramics.

Nevertheless, more remains to be done. Egypt's average MFN tariff rate is still high compared to rates in many successful developing economies, thus tending to divert scarce resources into less efficient activities and placing a burden on consumers. Tariffs are very high for a number of product lines such as poultry, tobacco products, and automobiles. An import ban on poultry offal and limbs remains in effect. Other nontariff barriers continue to exist in the form of unnecessary and nontransparent customs and other inspections and controls, expensive and unreliable transportation, a costly foreign exchange market, and inadequate systems for implementing temporary admission and duty drawback. These not only impede exports but also tend to protect import-competing industries, which creates an indirect bias against exports.

In the next few years Egypt must make some important choices regarding its approach to trade policy reform. These choices involve the possibility of further unilateral reductions in tariffs and other barriers to trade, multilateral trade liberalization through WTO, and the signing and implementation of regional and bilateral free trade agreements (FTA) that will be phased in during the next 10 years or more. Among the changes that Egypt faces in the international trade regime are

- The phasing out of textile and apparel quotas by the United States and European Union by January 2005, which will result in increased competition from low-cost suppliers in Asia;
- Egypt 's commitments to lowering tariffs on industrial goods under the European Union–Egypt Association Agreement and the potential for gaining greater access to the EU market for agricultural goods;

- The possibility of negotiating other FTAs, for example with the United States and South Africa;
- The proliferation of FTAs and association agreements involving the United States and European Union, which could isolate Egypt to the extent that it is not party to similar agreements; and
- The collapse at Cancun of the Doha Round of multilateral WTO trade negotiations, which may mean that regional and bilateral trade agreements become more important in the next few years.

This report examines the consequences for the Egyptian economy of expected changes in the world's trade regime, over which Egypt has only a modest degree of control, as well as the implications of those changes for the government's policy options and negotiation positions.

Egypt's Economy in Relation to the Global Marketplace

A review of trends in the structure of production, employment, and trade shows the growing importance of manufacturing and services and the decline of agriculture in terms of both output and employment. The private sector has grown in importance relative to the public sector, and now contributes about 70 percent of GDP, though the share of the private sector in output varies considerably among subsectors. In general, the private sector tends to be less labor-intensive than the public sector in manufacturing, which probably reflects the strong social obligation of public enterprises to employ more workers.

The unemployment rate in Egypt is nearly 10 percent. This unemployment is concentrated among those with secondary or tertiary education. Aside from those who are openly unemployed, many people employed in very low-productivity or part-time activities would like to be more gainfully employed full-time.

Egypt has been very successful, at least until recently, in re-establishing macroeconomic equilibrium. However, government fiscal deficits have reemerged in the last few years, threatening that stability. In addition, the devaluation and freeing of the exchange rate are adding to inflationary pressures.

The balance of payments data show the importance of petroleum exports, tourism, Suez Canal revenues, and remittances from Egyptians working abroad as sources of foreign exchange. Although there have been substantial fluctuations in each of these flows, the longer term trends have been relatively stable. This is in contrast to exports of goods other than petroleum, the value of which more than doubled from 1995/96 to 2002/03. This is an indication of substantial responsiveness of manufacturing and agriculture to changes in the trade and exchange rate regime, helping to increase the relatively low ratio of trade to GDP in Egypt as compared to a number of successful developing countries.

The analysis of the direction and composition of trade shows the overwhelming importance of the EU and the US as Egypt's most important trading partners. It also shows the predominance of basic foods and producer goods in Egypt's imports, which, together with relatively constant earnings from petroleum exports, tourism, the Suez Canal and worker remittances, suggests

relatively low responsiveness of imports and exports of services, and thus the bulk of balance of payments flows, to changes in prices and the exchange rate.

In 1991, Egypt began a comprehensive economic stabilization program, which, together with debt relief, resulted in low inflation, minimum fiscal deficits, improved balance of payments, reduced pressure on the exchange rate, and a substantial reduction in external debt. Egypt also implemented a package of trade reforms that eliminated many non-tariff barriers (NTBs), and substantially reduced tariffs and made them more uniform. In addutuib, through its Uruguay Round obligations to WTO, Egypt bound 98 percent of its tariffs, and agreed to a schedule of phased reductions over the period 1995-2005. As a result, between 1991 and 1998 Egypt's import-weighted average tariff fell by 50 percent. Tariff reductions cut the highest tariffs on imports from over 100 percent to 40 percent, with the exception of poultry, tobacco products, alcoholic beverages, and automobiles. As a result, the import-weighted average tariff reached a low of 12 percent after the most recent tariff reductions were introduced in January 2004. Bans on textiles and clothing were removed in 1998 and 2004, respectively

Despite this success, Egypt today is confronted with three major problems: instability of its major sources of foreign exchange, increasing unemployment associated with population growth but little capacity of agriculture to absorb workers, and continued need to expand the relative size of the private, compared with the public, sector.

The Egyptian economy has a number of distinguishing characteristics, which influence how it can best be integrated into the world market during the current phase of globalization. These include large reserves of oil and especially natural gas, geographical proximity to European and Middle Eastern markets, a relatively large number of people with higher education, a heritage of Egyptian culture, limited water resources of the Nile River in the face of growing population pressure, and a history of socialism and its aftermath.

With respect to the global marketplace, the growth of global trade and investment has occurred in three phases. The first phase from 1870 to 1914 was characterized by the exchange of primary products from the periphery for manufactured goods from the center of the industrial world. The second from 1945 to 1980 witnessed rapid growth of trade among the industrial nations, based largely on economies of agglomeration and scale, as well as trade with a few developing countries that were able to take advantage of low labor costs. The third phase from roughly 1980 to the present is evidenced by a continuation of earlier patterns and increased difficulty that countries specialized in primary product exports are having in diversifying their exports. Countries that have achieved economies of agglomeration and scale already have a competitive edge in those industries because of their head start. This includes the few developing countries that were able to avoid the disadvantages of their late start by competing in labor-intensive manufactures. Today, competitiveness depends not only on costs of production but also on the technology, managerial and marketing skills, and general know-how associated with investment in human capital. Essential, too, is good transportation as well as information and communications technology.

As Egypt prepares to participate more fully in the third phase of globalization, its economy may be conceptualized in terms of four broad sectors: rent-bearing, labor-intensive, economies of agglomeration and scale, and human-capital intensive. Foreign exchange is earned primarily by the rent-bearing sector (petroleum, Suez canal, tourism), which is relatively insensitive to costs. This can result in a "Dutch Disease" phenomenon, resulting in other, cost-determined exports being penalized by an overvalued exchange rate. Opportunities in the labor-intensive sector (garments, furniture) are more limited than they used to be because of strong competition from developing countries that gained a head start. Egypt has some advantage in industries that have existed for a long time, because of the resulting economies of agglomeration and scale (metal and metal products, pharmaceuticals), but it is in the human capital-intensive sector, with its large number of well educated workers and managers, that Egypt has the best opportunity to develop its future competitive advantage. This sector includes information technology and financial services, but human capital also contributes to many other industries, such as textiles and apparel, marble and ceramics, and motor vehicles.

An analysis was conducted, using data from the International Trade Center's TradeMap, of Egypt's revealed competitive advantage based on export trends in relation to the world market and on rates of import duty. Products were selected for further analysis if exports were substantial and growing rapidly in relation to world trade, or if there were relatively high rates of tariff protection. Among the products experiencing rapid rates of export growth are fresh fruits and vegetables, processed foods, carpets, men's and women's suits, marble and ceramic tiles, metals and metal products, and trucks. Highly protected products include poultry and automobiles.

Trade Policy and the International Trade Regime

Egypt has made much progress in reducing tariffs, but tariffs are still high when compared to other countries that have developed their export sectors. This creates a bias against exports by causing the exchange rate to be overvalued vis-à-vis free trade and by favoring the allocation of resources to import-competing industries. Tariffs also escalate up the value chain, resulting in effective rates of protection much higher than nominal rates for such industries as spinning and weaving and garment manufacture. In addition, some nontariff barriers continue to plague Egypt's trade regime:

- Customs and other clearances for imported goods and for some exports are complex. Goods classification and rates are sometimes arbitrary.
- A customs surtax is charged in addition to the import duty and sales tax.
- All imports are charged a service and inspection fee of 1 percent.
- Prolonged and complex procedures for obtaining the foreign exchange needed to import raw materials, intermediate products, capital equipment, and spare parts drive many firms to the parallel market, where foreign exchange is much more expensive. This is especially onerous for exporters, who are obliged to convert 75 percent of their net foreign exchange earnings to local currency at the bank rate of exchange.

- Many consumer goods are required to enter Egypt only after having been shipped directly from their country of origin.
- In some industries, such as the automotive industry, assemblers enjoy reduced duties on imports to the extent they use locally produced components in their finished products, which is a violation of WTO rules.

In addition to the unilateral steps it has taken towards tariff reduction and trade liberalization, Egypt has made a number of commitments as part of its membership in the World Trade Organization (WTO) and continues to enter into a series of regional and bilateral trade agreements. All these agreements have in a sense locked in Egypt's commitment to freer trade

Egypt has made substantial progress in meeting its WTO commitments. Among the few remaining deficiencies are the ban on imports of poultry offals and limbs, as well as a few duties that are in excess of bound rates for some dairy products, prepared meats, prepared fish, and industrial chemicals. These instances are not numerous in relation to the total number of tariff lines that meet, or in many cases surpass, Egypt's commitments. On the other hand, the non-tariff barriers described above are in violation of WTO.

With respect to preferential trade agreements, by far the most important of the regional and bilateral trade agreements is the European Union–Egypt Association Agreement, under which Egypt has agreed to eliminate tariffs on industrial goods coming from the European Union over 12 years. Industrial goods from Egypt already enter the European Union duty-free. In agriculture, the European Union has expanded the number of products subject to tariff rate quotas, increased the size of some of these quotas, and extended the period for some quotas. Much remains to be done in agriculture, and renewed negotiations are to take place after the third year of implementation of the agreement.

The European Union–Egypt Association Agreement is to become a part of the Euro-Mediterranean Free Trade Area to be in place by 2010 between the European Union-15 and 12 Mediterranean countries. Tariff concessions offered by the European Union under the agreement with Egypt are to be subject to rules of origin that are relaxed by permitting diagonal cumulating of origin across the 12 Mediterranean countries. This could be especially important for textiles and clothing.

With this agreement in place, an Egypt–United States FTA would be essential to maintaining equivalent access for U.S. products to Egypt's market. An agreement with Egypt would also fit the context of a United States–Middle East free trade area, which President Bush has proposed establishing by 2013. While an agreement to participate in Qualified Industrial Zones will help, an FTA with the United States could be critical for enabling Egypt to compete with exports of textiles and clothing from China and other Asian countries to the United States when the Agreement on Textiles and Clothing expires at the end of 2004. For such an agreement to be useful for Egypt appropriate rules of origin have to be included.

An FTA between the Southern Africa Customs Union (SACU) and Egypt could stimulate trade between the two largest markets and sources of supply on the African continent. However, the similarity of the overall structure of the economies implies some trade diversion, and the potential

for trade creation is unclear. Moreover, the SACU trade regime is complex, and overlapping rules of origin would involve SADC and COMESA. However, an FTA might encourage South African investment in Egypt.

The tariff regimes of Egypt's two major trading partners, the European Union and the United States, have tariff peaks in cereals, clothing, dairy products, footwear, red meat, sugar, textiles, and tobacco. Tariff escalation is prevalent in the European Union for red meat, sugar, tobacco, and wheat; in the United States for sugar and tobacco. The tariffs for most unprocessed and processed agricultural products are also influenced by tariff rate quotas. In the European Union, tariff rates on agricultural products outside of quota average 45 percent ad valorem equivalent, with rates on barley, sugar, and red meat in excess of 100 percent. In the United States, tariff rates within quota are relatively low, an average of 9 percent ad valorem equivalent, but tariff rates outside of quota can run much higher. The effect of reduced domestic price supports in the European Union and the United States on agricultural prices is a looming issue. Although such a reduction would raise prices for Egypt's cotton exports, it would also increase the cost of food imports.

Some have warned that Arab regional trade integration agreements, such as GAFTA, that consider only merchandise trade without considering trade in services, investment, and factor flows or institutional and regulatory issues, will not benefit Mediterranean Rim countries because their markets are too small and their economies too similar to benefit from trade alone. Liberalization in these complementary sectors is essential for improving competitiveness and broadening employment creation opportunities in service sector fields.

Under an FTA between Egypt and Turkey, the greater competitiveness and diversification of Turkey's economy would allow it to take advantage of opportunities in Egypt to a greater extent than Egypt could in Turkey. Because Egypt's economy is more protected than Turkey's, Egypt would be under greater import threat and subject to greater trade diversion after the FTA. Egypt's lower-cost labor, combined with its gateway status to COMESA and Arab markets, however, should make it a more attractive foreign direct investment (FDI) recipient than Turkey.

Significant lessons can be learned from the experience of other developing countries with FTAs signed with the United States. The United States–Jordan FTA has greatly increased Jordan's garment exports to the United States. It remains to be seen what the effect of the phasing out in 2005 of the WTO Agreement on Textiles and Clothing will have on a small exporter like Jordan.

Morocco is becoming a hub for labor-intensive manufacturing for export. Morocco's clothing assembly industry has been active for a long time under bonded warehouse arrangements, but industrial-component exports for the chemical, electrical, and automobile industries are becoming more important. Opening the U.S. market for these goods under the US-Morocco FTA will present Moroccan exporters with excellent opportunities, provided the problem of rules of origin can be overcome. On the other side, opening the Moroccan market to exports of wheat, feed grains, poultry, and beef from the United States will be a significant challenge to Moroccan agriculture and will require phasing in during a fairly lengthy period. Regardless of the impact on trade of the FTAs signed between the United States and both Jordan and Morocco, these agreements are likely to increase FDI flows from the US.

Following the creation of the North America Free Trade Area (NAFTA), there was rapid mutual expansion of trade in products and parts between Mexico and the US in such areas as electronics, computers, and motor vehicles. As the two economies were becoming more intertwined at various stages of the value chain, it was increasingly difficult to distinguish clear lines of competitive advantage in industry. However, the US also substantially expanded its exports of feed grains, soybeans, livestock products, and processed foods to Mexico. NAFTA has had a negative impact on employment in the agricultural sector in Mexico, especially among small poor farmers, because of the greater competitiveness of US exports of these products, but this has been compensated for by the gain in manufacturing employment due to both NAFTA and the *maquiladora* incentive program that preceded it. Nevertheless, because of higher wages in the export sector, this has led to greater income inequality.

The experience with NAFTA suggests that FTAs are often driven by manufacturers seeking to shift some or all of their production off-shore in order to take advantage of lower costs of doing business in emerging markets. An important positive spillover of FTAs can be an increase in supply-chain integration. Local firms become more likely commercial partners – as subcontractors, suppliers, joint venture partners, and possible merger or acquisition targets – of foreign firms. As supply chains become interwoven, workforce skills are transferred to enable a mid-level skill set to emerge, encompassing technical, business, and logistics managers who are capable of handling a greater proportion of the supply chain.

FTAs are sometimes negotiated between partners for reasons other than trade benefits. Other benefits might include increased investment flows, military aid, development-related technical assistance, diplomatic support for non-commercial issues, education and cultural exchanges, market linkages to overseas consumers, access to improved management practices, transfer of technology, and more facile entry into each other's countries for business and private travel. In addition to effects on output and employment, free trade agreements may also impact work conditions and the environment.

Impact of Trade Regime Changes on Subsectors

To understand how FTAs are affecting or are likely to affect individual firms we conducted detailed sector assessments assuming

- No changes in Egypt's trade regime other than implementation of obligations already incurred under existing agreements and enactment of existing legislation;
- Trade policy reform through the signing and implementation of FTAs and further commitments under WTO without undertaking any other changes in the existing trade regime and overall economic policy environment; and
- Trade reform continues to reduce the level and dispersion of tariffs and other economic policy adjustments combined with signing and implementation of additional FTAs and making further commitments under WTO.

We chose subsectors on the basis of (1) their revealed competitive advantage as measured by export performance, (2) their degree of import protection as measured by import duties and quantitative trade restrictions, and (3) the extent to which the industry was successful in finding export markets or fearful of being challenged by imports.

The extent to which trade policy reform can be expected to increase opportunities for production and employment or threaten subsector survival of the subsectors depends on several factors:

- Creation of export opportunities rather than the diversion of trade from less costly to more costly sources of supply;
- Exploitation of economies of agglomeration and scale accompanied by market enlargement and cost reduction;
- Increased competition in import-competing industries, with resulting adverse effects on output and employment in the short run although the long-term impact may be more efficient allocation of scarce resources; and
- Increased flows of trade and FDI, which result in transfers of capital, skills, technology, and management.

The subsectors studied are fresh fruits and vegetables, processed food, poultry, cotton, textiles and garments, furniture and other wood products, marble and ceramics, pharmaceutical products, motor vehicles, and information technology. Other sectors that were identified as being of interest but could not be included in the detailed sub-sector analysis, because of time constraints or difficulties in meeting with industry representatives, included fertilizers, cement, metals and metal products, electronic products, and financial services.

Fresh flowers, fruits, and vegetables. This subsector has a strong competitive advantage because of Egypt's soil, climate, and proximity to European and Middle Eastern markets, but costly and unreliable air freight services threaten this advantage. Egypt needs to deal with this problem and to press the European Union to open its markets to the products of this subsector and to processed foods in return for tariff reductions on European industrial goods.

Processed foods. Multiple, arbitrary, and highly variable inspections and controls on imports, exports, and their inputs cause long delays and drive up costs in this subsector.

Poultry. This subsector receives very high trade protection, principally because EU and U.S. producers cover their costs by selling chicken breast on domestic markets at a premium and exporting chicken limbs at very low prices. The industry requires safeguards against surges in imports, and perhaps countervailing duties, but should eliminate the ban on imports of poultry offal and limbs and reduce the tariff of 80 percent on all poultry imports. There is a good possibility of restructuring the industry so that it can export processed chicken and be more competitive in the domestic market.

Cotton. Because of its soil and climate, Egypt has a strong competitive advantage in producing long and extra long-staple cotton. Production in Egypt declined during the 1990s mostly because of government interference in marketing and price structure, but also because other crops are subsidized by a lack of any charge for scarce water. One result of such market interference is that

spinning mills have difficulty obtaining cotton. Egypt needs to concentrate on exporting its high-quality cotton, raw or processed, and importing lower-quality cotton to produce textiles and garments for the domestic market.

Textiles and garments. Egyptian exports of garments to the United States will be threatened by the phasing out of the Agreement on Textiles and Clothing at the end of 2004. An FTA with the United States might help, but only depending on the rules of origin agreed to. Egypt also has an opportunity to export garments to the European Union under new rules of origin allowing diagonal cumulating among Mediterranean countries. There are also good possibilities for developing an integrated, high-quality cotton apparel export industry using Egyptian cotton.

Furniture and wood products. The wood carving segment of the furniture and wood products industry will benefit from tariff reductions on imported wood under the European Union–Egypt Association Agreement. But the small-scale, handcrafted furniture industry, which produces mostly for the low end of the domestic market, would have to compete with mass produced, low-quality furniture coming from the United States under an FTA. The agreement would have to contain reasonable safeguards and a lengthy period of adjustment to avoid unemployment.

Pharmaceutical industry. The pharmaceutical industry is in serious trouble because retail prices have been fixed at the same level for about 10 years. Because of heavy dependence on imported inputs and the rise in the prices of these inputs associated with devaluation, the industry is decapitalizing rapidly and firms will soon start going out of business. The alternative is to orient production toward the export market, which will lead to the collapse of production for the local market and the need for the government to import pharmaceuticals to meet domestic market demand. If government supplies are inadequate than pharmaceutical products will be smuggled into Egypt and sold on the parallel market at whatever prices consumers are willing to pay.

Marble and ceramic tiles. Marble and ceramic tiles have been two of Egypt's most successful exports. Egypt has almost limitless supplies of superb marble and demand for it is expanding rapidly, especially in the United States. The major constraint on production is lack of equipment for finishing and polishing. Firms in this subsector need to band together to achieve economies of agglomeration via investment in market information and input supply.

Motor vehicle assembly. Though this is a highly protected sector, some areas in it appear to be efficient. For example, a firm producing buses, trucks, and tractors was hived off a larger, state-owned firm, which absorbed all debt and redundant labor. The new firm has made a profit for three years and has even exported. This is an innovative approach to revitalizing one of Egypt's less efficient industries. The firm uses locally produced components in many product lines, perhaps because of government financial incentives.

Information technology. Information technology (IT) is a fertile area for entrepreneurs in Egypt because economies of scale are limited. But economies of agglomeration are possible, which is why the government is trying to induce firms to group together. The main problem for new companies is access to working capital. Egypt has a very good opportunity to export software to the Arab states not only because of its proficiency in Arabic but also because of its pool of skilled programmers and other computer specialists.

Constraints common to all subsectors include

- ***Foreign Exchange.*** Firms are required to convert 75 percent of their net foreign exchange earnings into local currency at the bank rate of exchange. Yet when they try to recover the foreign exchange to purchase inputs or other needs, they experience complex procedures and long delays. As a result, they usually end up obtaining foreign exchange on the parallel market at a significant loss.
- ***High Cost of Imported Inputs.*** The cost of importing machinery, spare parts, raw materials, and intermediate inputs is high because of customs duties, sales tax, special import surcharges, port fees, port delays resulting in storage fees, customs officials requiring a receipt certified by the Egyptian embassy in the country of origin to establish value, and GOIEC procedures that are slow, cumbersome, and costly. Many of these taxes and other fees are not deductible when final products are exported. Nor is there any incentive scheme whereby expenditures on capital equipment can be considered as a credit against corporate profits tax.
- ***Arbitrary Customs Valuation.*** Customs valuation is frequently arbitrary and based on price lists that have little to do with prices actually paid. This violates the transactions approach to valuation, which Egypt has subscribed to as a member of WTO. Smaller exporters especially are frustrated in dealing with always-changing customs rates, requirements, and procedures.
- ***Duty Drawback and Temporary Admission Procedures.*** These procedures either do not work or are so complex and lengthy that many firms do not bother to use them. This is especially a problem for smaller firms.
- ***Access to Finance.*** SMEs especially lack access to capital for the equipment purchases, market development, and working capital essential to growth.
- ***Lack of Cooperation among Firms.*** Firms do not cooperate or share costs to improve marketing intelligence, design capability, and distribution contacts. Many do not realize that, when exporting, the competition is a company in another country, not in Egypt.

Conclusions

Egypt has made rapid strides in expanding exports of goods other than petroleum. There are numerous examples at the sub-sector level (fresh flowers, fruits, and vegetables; processed foods; ready-made garments; wool suits made in vertically integrated enterprises; marble and ceramic tiles; computer software) of individual companies that have seized export opportunities. Most of these industries have required substantial adjustments to meet the high quality standards of foreign markets. Even where the competitiveness of these industries is based in part on natural resource advantage, developing this advantage has required education, technical and management skill, and other forms of human capital that Egypt has in some abundance. All of these exporting industries would benefit from freer trade, whether as a result of unilateral action or multilateral, regional, and bilateral agreements.

Other sectors have significant problems that could expose them to injury from freer trade. Often these are industries that are very labor intensive and produce products of low quality for the

domestic market, which might have a difficult time competing with cheap labor-intensive or mass-produced imports from Asia or even the industrial world. Two examples are competition from imports of low quality furniture and used clothing. Although Egypt might be able to produce labor-intensive goods for export, the country does not appear to be very competitive at the lowest level of skills. Rather, Egypt's comparative advantage seems to lie in combining low-cost labor or natural resources with higher-level technical and managerial skills. One example might be integrated, high-value cotton-textiles-garments. Another might be electronic assembly. Still another is marble and ceramic tiles.

Egypt does appear to have some advantages in exploiting economies of agglomeration and scale. This is probably true in textiles, industrial chemicals, pharmaceuticals, metal and metal products, and motor vehicle assembly. If these industries can be restructured and modernized, they may be able to establish a significant competitive advantage within the region.

One problem is that Egypt's economy runs the risk of being driven by the rent-bearing sector, in which most of the supply of foreign exchange is determined independently of costs and is quite variable depending on the world market for petroleum and on the political and military situation in the Middle East. Distribution of benefits from the earnings of this sector tend to be somewhat unequal, resulting in large demand for imports by middle and upper income groups. Given that industrialization goes back to the 1930s and received strong impetus under President Nasser, pressures for protection have been strong. This has tended to discourage imports of consumer manufactured goods and to favor imports of producer goods and food, which are also relatively inelastic with respect to price and not very cost sensitive, e.g., machinery for the petroleum industry, electronic machinery and equipment, cereals, motor vehicles, aircraft, iron and steel, etc. The result has been substantial appreciation of the real exchange rate independent of the cost structure of the economy. This could have serious consequences for sectors in which cost is an important element of competition, e.g., cheap furniture, low quality clothing, poultry parts. It could also seriously penalize exports.

If tariffs continue to decrease and the Egyptian economy becomes less protected, both exports and imports can be expected to increase, with exchange rate equilibrium being determined much more by costs, especially on the import competing side. With lowering of tariffs in the presence of a free exchange rate, it is likely that imports will expand first, causing the exchange rate to depreciate, which will cushion the blow of tariff reduction on sectors that are particularly vulnerable. It could take years, however, (1) for price signals to work their way through the marketing system until consumers respond to lower import protection, and (2) once that response has taken place and the exchange rate has depreciated, for producers to adjust. No matter what the process for trade policy reform, the time allowed for adjustment should be reasonably lengthy.

Deciding which approach to use—unilateral tariff reduction and trade liberalization, multilateral WTO negotiations, or pressing forward with regional and bilateral FTAs—involves political as well as economic considerations. In the end, all three approaches probably should be used because they are complementary. Egypt has already undertaken unilateral action, made commitments under WTO, and signed regional and bilateral trade agreements. For the most part, these will all

have largely positive effects, especially if time is allowed for adjustment, if safeguards are used to protect vulnerable sectors, and if complementary policy reforms ease the transition.

Furthermore, continuing to negotiate and sign FTAs (e.g., with the United States and SACU) offers advantages far beyond those directly related to trade. These include FDI, transfers of technology and managerial skills, increased confidence among tourists and others travelers to Egypt, and increased confidence among Egypt's young entrepreneurs, who will ultimately be the ones to cause Egypt's economy to grow and to link its destiny with the rest of the world.

To maximize benefits from tariff reduction and trade liberalization, Egypt must put in place the infrastructure, institutions, and policies necessary to reallocate resources. Port, airport, and transportation systems need to be upgraded; regulatory controls and administrative procedures need to be simplified; government intervention in price and marketing systems needs to diminish; SMEs need more access to financing; public enterprises need to be privatized or made more efficient; the foreign exchange market needs to be more efficient; tax incentives for exports and investment need to be improved; and workers and managers need adequate and appropriate education and training. And, in order to prepare for, negotiate, and implement trade agreements policymakers need information on the effects of trade-related policy actions on local industries.

The investigation thus far has been based on interviews with only a few leaders within each industry. Some of the important industries identified in the report have not been covered. There is a need to extend the range of contacts to hear varying opinions and to achieve wider coverage. There is also a need for greater quantification of the effects of trade and economic policy reform. One practical approach lies in the estimation of single-market consumption, production, trade, and employment effects. The logical connections among sectors can then be established to give policy makers a sense of how these partial impacts would be connected in a broader, economy-wide context.

Next Steps

Egypt could benefit from further trade policy reform by (1) signing and implementing existing and additional FTAs, (2) making further commitments under the WTO, and (3) unilaterally reducing tariffs and nontariff barriers and making other policy adjustments. Short-term costs could be reduced and more easily borne if a good business establishment were created through policy reforms.

A practical approach to reform will enable Egypt to benefit from the opportunities and challenges of the changing global trade regime while taking into account the time required for internal restructuring. Egypt will have to decide whether to move resources out of product lines in which it does not have a comparative advantage or rehabilitate those lines to make them more competitive. It may be possible in some cases to shift resources among lines within a subsector rather than abandon the subsector altogether.

Egypt has already embarked on a very extensive program of tariff reduction for industrial goods under its Association Agreement with the EU. In addition, as a member of WTO, Egypt is committed to removing a number of nontariff barriers described earlier. It is also committed to moving ahead with multilateral trade reform, although that process has slowed somewhat following the meetings in Cancun. Aside from these major commitments, Egypt is party to a number of other regional and bilateral agreements, including GAFTA and COMESA. Other options include free trade agreements with the United States, the Southern Africa Customs Union, and Mercosur.

Egypt's wide array of agreements could create a tariff schedule of enormous complexity—with duty rates differing not only by product code but also by country of origin. Policing this schedule would require complex rules of origin. Egypt's customs service already has significant problems overseeing the application of existing rules, and these problems could easily get worse. In addition, by eliminating tariffs on trade with some countries and not others, Egypt could experience substantial trade diversion. For example, if agricultural machinery was initially imported from the United States because of low cost and good quality, and then imports shifted to the European Union because tariffs on imports from the European Union were eliminated, overcoming the competitive advantage of the United States, Egypt would lose by having to pay more for its machinery.

These are strong arguments for establishing FTAs that all apply the same program of tariff reduction. Because the European Union–Egypt Association Agreement is the most important of Egypt's agreements, it should be the model for others. Exceptions could be made for industries threatened by imports from outside the European Union, but these would be justified according to the threat imposed. For example, an FTA with the United States might be more threatening to Egypt's small-scale furniture industry than the existing agreement with the European Union, in which case a longer period of protection from U.S. imports might be desirable.

The other major exception is agriculture. The Association Agreement is specific about tariff rate quotas on Egypt's agricultural and processed food exports to the European Union. Some concessions have been granted and discussion of further concessions is planned. In addition, tariff reductions on agricultural products outside the tariff rate quota for Egypt or the European Union have been left to future negotiations. How agriculture is to be handled under other FTAs is unclear, but special measures will have to be taken for sensitive subsectors (e.g., import of poultry offal and limbs).

Traditional and nontraditional horticultural crops are competitive not only in the domestic market but also for export; solving air transport problems would make this industry even more competitive in European and other markets. Tariff rates of 20–40 percent are not necessary and could be phased out in return for other tariff concessions. It may be possible to use the tariff reductions that are proposed in the report on these products and on prepared foods to obtain concessions on horticultural crops entering the European market, the largest export market for these crops. In negotiating FTAs, Egypt should also consider reducing tariffs for horticultural products in exchange for other concessions. For example, SACU has a tariff of 20 percent on imports of ceramic tiles. Egypt could benefit from the elimination of this duty.

Egypt is less competitive in processed foods. Nevertheless, exports have expanded, especially following devaluation. Solving port clearance problems would help this industry compete in domestic and export markets at the tariff rate reductions that are proposed.

Poultry is a very sensitive industry. This is largely because the United States and the European Union export poultry offal and limbs at very low prices, recovering costs on domestic sales of chicken breasts. Egypt could adapt to this market by increasing exports of white meat in the form of cold cuts and other processed products, but this will take time. In the meantime, the first priority should be to eliminate the ban on imports of poultry offal and limbs, which violates WTO regulations. Egypt always has recourse to WTO's safeguard clauses to protect against a sudden surge in imports. The situation can be reviewed periodically to see whether further tariff reductions are warranted beyond the very limited ones proposed in the report

Egypt appears to have a clear comparative advantage in the marble and ceramics industries. The slow pace of tariff reduction scheduled in the European Union–Egypt Association Agreement is probably unnecessary. Egypt could use this as a bargaining chip in tariff negotiations with SACU or the United States.

Tariff protection on pharmaceuticals is already low. The problem in this subsector is not tariffs but controlled prices. If these are not raised, neither imports nor domestic production for the local market will be profitable.

Egypt appears to have a strong comparative advantage in nitrogenous fertilizers, largely because of its low energy costs. Exports in 2002 were $124 million whereas imports were only $3 million. Thus there is little reason for tariff rates to be as high as they are. This could be another industry in which Egypt makes tariff concessions greater than those in the Egypt–European Union Agreement.

The cotton-textiles-clothing value chain exhibits high tariff rate escalation. Egypt has recently agreed to reduce tariffs to meet its WTO commitments. When these agreements are implemented, the industry will face sharply increased competition. It will also enjoy opportunities if (1) the marketing and pricing of raw cotton is liberalized; (2) the import of short and medium-staple cotton for the domestic market is encouraged; (3) restrictions on purchases of imported cotton by spinning mills are reduced; (4) spinning, weaving, and especially finishing and dying are modernized; (5) production of high-quality apparel and home textiles made of long and extra long-staple Egyptian cotton is developed; and (6) clothing exporters have better access to tax-free imported fabrics and other inputs. With these reforms, the tariff reduction schedule in the Egypt–European Union Agreement can be met.

The metals and metal products industry also has substantial scope for reallocation of resources to improve competitiveness. For example, exports of flat rolled iron products have increased rapidly in recent years, whereas other products, such as bars and rods, have not fared as well. Aluminum and its products have also done nicely. The general trade record suggests that the industry as a whole can be competitive. Therefore, the tariff reduction schedule set out in the Egypt–European Union Agreement seems reasonable.

The motor vehicle industry has substantial opportunities and challenges. Although the import duty on passenger cars of 135 percent is higher than for any other product, the industry also includes the manufacture of buses, trucks, and tractors, which appears to be reasonably efficient—carrying a duty of only 5 percent to 40 percent and exporting some of these products. In addition, the industry has substantial linkages with smaller suppliers. This industry needs to make efficiency upgrades, reallocate resources to the most competitive activities, and eliminate activities that are unlikely to be competitive. This is a big industry and this process is going to take time, which is allowed for in the European Union–Egypt schedule of tariff reduction. In the end some factories may have to close, but by then most employees should have been able to retire or find other jobs.

The furniture and wood products industry offers scope for modernization and reallocation as well. This will not be as easy as in some industries because a large part of the subsector is made up of small firms producing cheap furniture for the low end of the domestic market. If these firms were suddenly faced with competition from cheap imports, unemployment could be severe. The tariff reduction schedule set out in the Egypt–European Union Agreement must be monitored closely and assistance must be offered to ensure that the industry can make the necessary adjustments. In addition, special protection may be required against cheap furniture imports if an FTA is signed with the United States.

Egypt has signed the Agreement on Information Technology, and accordingly will eliminate all its tariffs on computer equipment by 2007. It also has made commitments regarding telecommunications services as part of the General Agreement on Trade in Services. The European Union–Egypt Association Agreement calls for cooperation in information technology. The IT subsector is already substantially liberalized so that further commitments are unlikely to have much impact.

These observations and recommendations are for only a few product lines in the subsectors chosen for detailed analysis. Nevertheless, the principles upon which they are based should apply to a much broader segment of the Egyptian economy, although verification of this will require more subsector studies.

1. Introduction

Egypt has undertaken substantial policy reforms in the past few years. First, by reducing fiscal deficits, slowing the growth of money and credit, lowering the inflation rate, and reducing interest rates Egypt has achieved macroeconomic stability. Egypt has also devalued its currency and freed up the exchange rate. This has been accompanied by trade policy reform, which has eliminated most quantitative restrictions, lowered tariff rates, and made them more uniform across product lines. Some of these reforms have been unilateral and others have been linked to commitments made as a member of the World Trade Organization (WTO).

The results of these reforms have been marked. Exports other than petroleum more than doubled from 1995/96 to 2002/2003. Many business leaders report that exports increased strongly after devaluation in early 2003. Sectors that are reported to have benefited from this export growth include fresh horticultural crops, processed foods, cotton lint and yarn, garments, marble, and ceramic tiles.

Nevertheless, more remains to be done. Egypt's average MFN tariff rate is still high compared to rates in many successful developing economies, thus diverting scarce resources into potentially less efficient activities and placing a burden on consumers. Some product lines have very high tariffs, such as poultry, tobacco products, and automobiles. A ban on poultry offal and limbs remains in effect. Although the situation has improved in recent years, nontariff barriers continue to exist in the form of unnecessary and nontransparent customs and other inspections and controls, expensive and unreliable transportation, a costly foreign exchange market, inadequate systems for implementing temporary admission and duty drawback, and other barriers to trade that this report outlines in detail. These barriers not only impede exports but also tend to protect import-competing industries, which creates an indirect bias against exports.

In the next few years Egypt must make some important choices about its approach to trade policy reform. These involve the possibility of unilateral reductions in tariffs and other barriers to trade, participation in multilateral trade liberalization through WTO, and the signing and implementation of regional and bilateral free trade agreements (FTA) that will be phased in during the next decade or more. Among the parameters that Egypt faces in this changing international trade regime are:

- The phasing out of textile and apparel quotas by the United States and European Union by January 2005, which will result in increased competition from low-cost suppliers in Asia.
- Egypt's commitments to lowering tariffs on industrial goods as part of the European Union–Egypt Association Agreement and the potential for gaining greater access to the EU market for agricultural goods.
- The possibility of negotiating other FTAs, such as with the United States or Southern Africa Customs Union (SACU).
- The proliferation of FTAs and association agreements involving the United States and EU, which could tend to isolate Egypt to the extent that it is not party to those agreements.
- The collapse at Cancun of the Doha Round of multilateral WTO trade negotiations, which may mean that regional and bilateral trade agreements will assume increased importance during the next few years.

In this report we examine the consequences on the Egyptian economy of these and other changes in the world's trade regime, over which Egypt has only a modest degree of control, as well as the implications of those changes for the government's policy options and negotiation positions. Understanding the implications of these external factors on Egypt's policy choices is important. Through careful adoption of policies, the Government of Egypt can take maximum advantage of opportunities presented by changes in the trade environment while limiting temporary dislocation. Furthermore, while trade policy is important in this area, other economic policies also have a significant impact on the effectiveness of trade policy.

In Section 2 we examine Egypt's economy and its place in the global arena, briefly reviewing the structure of production, employment, and trade, and summarizing the reform program on which Egypt has been embarked for several years. We also discuss problems such as the instability of Egypt's foreign exchange earnings, growing unemployment with little capacity of agriculture to absorb workers, and the desirability of continuing to expand the private sector and reduce the size of the public sector. We then examine distinguishing characteristics of the Egyptian economy and how it can best be integrated into the world market during the ongoing third phase of globalization. We conclude by analyzing Egypt's competitive advantage revealed by its export trends in relation world market trends and import duty rates.

In Section 3 we examine trade policy in Egypt and its relation to the international trade regime. We review tariff structure as it has evolved during the past ten years, both unilaterally and as a result of Egypt's commitments under WTO; various nontariff barriers that still remain; various multilateral, regional, and bilateral agreements to which Egypt is a party or could become a party in the near future—such as possible FTAs with the United States or SACU; and the trade regimes of Egypt's major trading partners. We conclude with a discussion of findings from various studies of the economic impact of trade agreements on the economies of other countries.

Section 4 summarizes the impact that changes in the trade regimes of Egypt and its partners are likely to have on key subsectors of the Egyptian economy. These subsectors comprise fresh flowers, fruits, and vegetables; processed food; poultry; cotton; textiles and garments; furniture and other wood products; marble and ceramics; pharmaceutical products; motor vehicles; and information technology. We assess the results of the subsector analyses in terms of the extent to which trade policy reform—unilateral, multilateral, or regional/bilateral—can be expected to offer opportunities for expanded production and employment or whether it is likely to create challenges for Egyptian industry. Our analysis assumes three major options:

- No changes in Egypt's trade regime other than implementation of obligations already incurred as a result of the signing of existing agreements and enactment of existing legislation;
- Trade policy reform through the signing and implementation of existing and additional FTAs and further commitments under WTO without undertaking any other changes in the trade regime and overall economic policy environment; and
- Trade reform that continues to reduce the level and dispersion of tariffs and other economic policy adjustments combined with signing and implementation of FTAs and WTO commitments.

Section 5 summarizes our major conclusions and proposes next steps for tariff reduction and other policy changes. Details regarding the subsector analyses are presented in Appendix A. Appendix B provides tables of Egypt's trade with the European Union, United States, Middle East, and SACU. Appendix C lists persons and organizations contacted for this report.

2. Egypt's Economy and Its Place in the Global Arena

Egyptian Economy Today

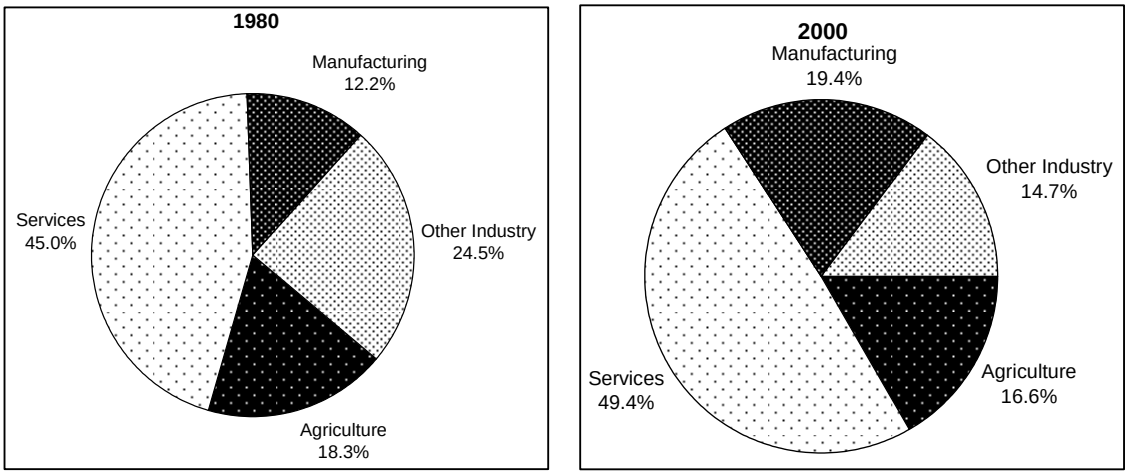
Egypt is a middle-income country with a $70 billion GDP in 2002. Real GDP in 1998 was 1.42 times GDP in 1990 and 2.6 times GDP in 1980, indicating some slowing in the rate of economic growth. Nevertheless, Egypt's economy grew at an average rate of 4.5 percent during 1990–2000, until recession during the early 2000s reduced average annual growth to 3.2 percent. Population growth of more than 3 percent per year in the 1980s, reduced to 2.1 percent annually in the early 2000s, resulted in corresponding growth rates of per capita income that are lower, reaching 1.2 percent on average in the past three years. When converting these numbers to account for differences in international purchasing power, the GDP per capita in 2000 was $3,600.

STRUCTURE OF THE ECONOMY

The contributions of the different economic sectors to Egypt's GDP have changed in the past 20 years, with a larger share for manufacturing and services at the expense of agriculture and other industry. Services increased from 45 percent of GDP in 1980 to 49.4 percent in 2000. Similarly, the manufacturing sector's share in GDP rose from 12.2 percent to 19.4 percent (see Figure 2-1).

In addition, the share of the private sector in GDP increased during the past two decades, reaching more than 70 percent of GDP in 2002/03. Sectors such as agriculture, real estate, tourism, and manufacturing are predominantly private, ranging from close to 100 percent private ownership for agriculture, tourism, and real estate to more than 80 percent for manufacturing. Private participation has also increased in utility sectors such as electricity and water, which were originally fully owned by the public sector, until it now contributes about 5 percent of the sector's GDP.

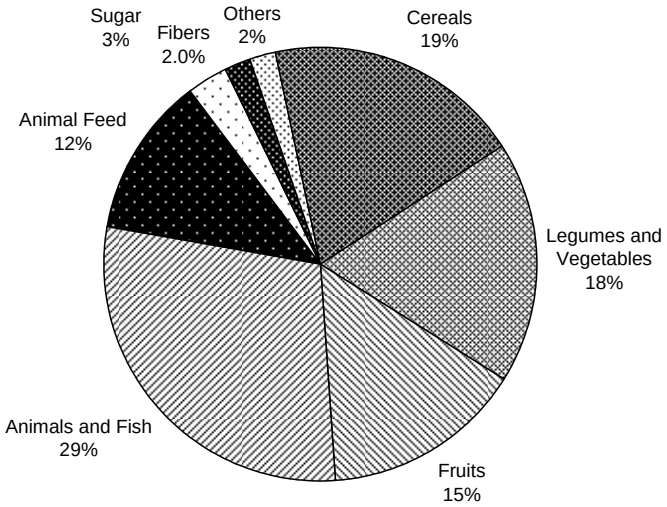
Figure 2-1
Sector Share in Egypt's GDP 1980 and 2000



Agriculture

Agriculture accounted for about 16 percent of GDP in 2002/03, down from more than 18 percent in 1980. The average annual growth rate of agricultural production was 3.5 percent in the 1980s and 1990s. Agriculture continues to account for 30 percent of total employment. Thirty-three percent of total agricultural output is accounted for by fruits, vegetables, and legumes. An additional 19 percent is cereal production, and 29 percent is animal and fish production (see Figure 2-2).

Figure 2-2
Egyptian Agricultural Production by Commodity 1999–2000



Manufacturing

Manufacturing accounted for 19 percent of GDP in 2002/03, up from 12 percent in 1980. Average annual growth in industrial output during the past decade was consistently more

than 10 percent. The main sectors contributing to manufacturing output are food processing, spinning and weaving, and chemicals, accounting collectively for 40 percent of total output value in 1999/2000.

Sixty-eight percent of manufacturing output is produced in the private sector. This ratio varies from one industry to another. In furniture and wood products, 90 percent of output is from the private sector. The situation is similar for motor vehicles and parts, where 88 percent of output is produced by private companies. For clothing and garments, the share of private sector production is 72 percent of total output. In electronics, 76 percent of output is produced by the private sector. In contrast, for the tobacco industry, less than 10 percent of output is privately produced.

Private and public sector employment is more evenly distributed, with private manufacturing employing 52.6 percent of total employment, leaving 43.8 percent employed by the public sector. This suggests that public enterprises tend to be more intensive in the use of labor than private firms. Because private sector firms employing 10 or fewer workers produce 10 percent of private manufacturing output but make up 34 percent of private employment in manufacturing, greater employment in the public sector does not appear to be due to the size of firms. Rather it appears that public enterprises have a social obligation to employ more workers than do private firms, even if their productivity is low.

A privatization program that targeted 318 public sector companies resulted in privatizing 194 of these companies with total proceeds to the government of more than 16 billion Egyptian pounds. Plans to privatize remaining public sector firms will reduce the share of the public sector further in terms of both value added and employment.

Services

Services contribution to GDP is almost 50 percent, which is typical for developing countries. The more advanced an economy is the higher the contribution of services to GDP. For example, tourism, Suez Canal fees, and transportation account for 12 percent of GDP and are Egypt's main sources of service exports. Trade, finance, and insurance account for 21 percent of GDP while construction and real estate services represent 4 percent.

Several laws have been passed that encourage private participation in various aspects of economic activity. These include the investment encouragement law (8/1997), Law 155/1998 and Law 156/1998, allowing full privatization of public banks and insurance companies, respectively. Laws allowing build-operate-transfer in the infrastructure and utilities sectors, such as airports, electricity generation, and roads, have also been passed, resulting in a privately owned and operated airport in Marsa Alam.

LABOR FORCE, EMPLOYMENT AND UNEMPLOYMENT

One of Egypt's most important resources is its large and growing labor force. With a population growth rate that was higher than 3 percent annually but has declined to 2.1

percent during the past few years, Egypt's total population reached approximately 70 million in 2002/03, with a labor force of 20.2 million. Sixty percent of total population is under the age of 24 (education age). This pattern of population distribution is estimated to add more than half a million workers to the labor market annually.

Unemployment was estimated at 9.9 percent in 2002/3. The majority of unemployed are relatively well educated, with high and intermediate degrees. Recent government efforts to deal with unemployment have involved employment programs of new graduates in government. This is seen by the government as a temporary solution to unemployment, and other solutions will need to be devised. Aside from those openly unemployed, many more people who are employed in very low-productivity or part-time activities would like to be more gainfully employed full time.

The private sector employs close to 70 percent of Egypt's 12 million workers, while the government sector employs more than 5 million workers (30 percent of total employment). Most of these workers are in the administrative and services sectors such as education and health.

MACROECONOMY AND BALANCE OF PAYMENTS

Table 2-1 shows some important macroeconomic indicators from the past six years. It indicates that inflation has been relatively low and stable during the entire period despite a tendency for fiscal deficits to grow and depreciation of the Egyptian pound as a result of devaluation. The current account, which was in surplus 1991–1996, fell into deficit in 1997/98, largely because of a drop in tourism receipts, but it recovered to reach a $1.95 billion surplus in 2002/03.

Table 2-1
Selected Macroeconomic Indicators

Indicator	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
Average annual inflation (%)	3.8	3.8	2.8	2.4	2.4	3.20
Average annual foreign exchange rate E£ /US$)	3.40	3.40	3.45	3.85	4.34	5.13
Nominal interest rate	8.80	8.82	9.09	9.09	7.80	8.31
Unemployment (%)	8.2	8.1	9.0	9.2	9.0	9.90
Fiscal deficit (%)	-1.0	-2.9	-3.9	-5.6	-5.9	-6.2
Current Account (% GDP)	-2.9	-1.9	-1.2	-0.04	0.7	2.3
Foreign Debt (% GDP)	33.2	31.2	28.2	28.5	32.8	35.60

SOURCE: MOFT and Central Bank of Egypt.

Table 2-2 shows the principal elements in the balance of payments from 1995/96 to 2002/03. Egypt typically runs a trade deficit, which is covered by net exports of services and transfers.

Table 2-2
Summary of Balance of Payments Transactions, 1995/96-2002/03 (US$ million)

Transaction	1995/ 1996	1996/ 1997	1997/ 1998	1998/ 1999	1999/ 2000	2000/ 2001	2001/ 2002	2002/ 2003
Trade Balance	-9,498	-10,219	-11,771	-12,524	-11,472	-9,363.1	-7,517	-6,575
Export proceeds	4609	5,345	5,128	4,445	6,388	7,078	7,121	8,205
Petroleum	2226	2,578	1,728	1,000	2,273	2,632	2,381	3,161
Other Exports	2383	2,768	3,400	3,445	4,115	4,446	4,740	5,044
Import payments	-14,107	-15565	-16,899	-16,969	-17,860	-17,860	-16,441	-1,644
Services (net)	5,792	6193	4,692	5,946	5,630	5,588	3,878	4,916
Receipts	10,636	11,241	10,455	11,015	11,426	11,696	9,618	10,447
Of which Suez Canal dues	1,885	1,849	1,777	1,771	1,781	1,843	1,820	2,236
Travel	3,009	3,646	2,941	3,235	4,314	4,317	3,423	3,796
Payments	4,845	5,048	5,764	5,069	5,769	6,109	5,740	5,531
Balance of goods & services	-3,707	-4,027	-7,079	-6,578	-5,815	-3,776	-3,,638	-1,659
Transfers	3,521	4,145	4,600	4,869	4,680	3,742	4,252	3,608
Private transfers (net)	2,798	3,256	3,718	3,772	3,747	2,973	3,109	2,944
Balance of current account	-185	119	-2,479	-1,709	-1,162	-33	614	1,950
Capital & financial account	1,017	2,041	3,387	880	-1,199	-542	-964	-2,787
Direct investment in Egypt (net)	627	770	1,104	711	1656	509	428	701
Portfolio investments in Egypt (net)	258	1,463	-248	-174	473	261	999	-405
Other investments (net)	148	-145	2,724	442	-3,273	-1,280	-2,373	-3,036
Overall balance	571	1,912	-135	-2,117	-3,027	871	-456	654
Change in Reserve Assets (increase = -)	-571	-1,912	135	2,117	3,027	871	456	-546

SOURCE: *Central Bank of Egypt and MOFT*

Four items make up the bulk of foreign exchange receipts. In 2002/03, for example, oil exports were $3.2 billion, Suez Canal revenues $2.2 billion, tourism $3.8 billion, and Egyptian workers' remittances $3.0 billion. Although there were substantial year-to-year variations in these receipts, the overall trend during the period considered was fairly constant. For example, remittances were $2,944 million in 2003 compared to $2,794 million in 1995/96, and Suez Canal dues, tourism, and travel increased by only 20 percent during the period 1995/96 to 2002/03. This contrasts with more than a doubling of non-oil goods exports during the same period. In 2002/03, non-oil goods exports made up more than 60 percent of total goods exports, up from 52 percent of total exports of goods in 1995/96. This indicates substantial responsiveness on the part of manufacturing and agriculture to changes in the trade and exchange rate regime.

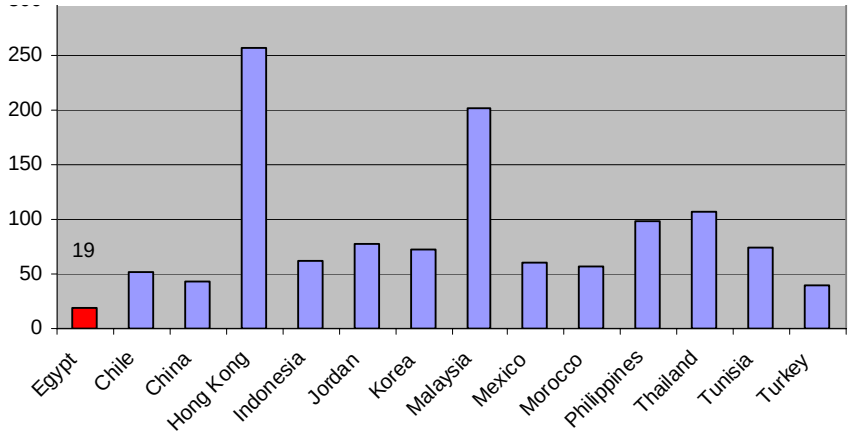
Foreign direct investment (FDI) and portfolio investment were also significant in the first half of the 1990s but then decreased as a result of the East Asian financial crisis, the continued overvaluation of the Egyptian pound, expectations regarding devaluation, and a number of banking and other monetary policy issues that had not yet been addressed. Portfolio investment hit a low in 1997/8 ($248 billion net) because of to the Asian crisis. Financial investment flows rebounded afterwards, reaching close to $1 billion in 2001/02, but the capital account remained negative as a result of continued debt repayment and limited FDI.

TRADE PATTERNS

Egypt's share in world exports of goods was 0.15 percent in 1980 and fell to 0.07 percent in 2001. As for imports, the corresponding shares in world trade were 0.23 percent in 1980, falling to 0.20 percent in 2001. World trade in 2001 was three times world trade in 1980, but Egypt's exports in 2001 were only 1.36 times Egypt's trade in 1980, and Egyptian imports in 2001 were just 2.63 times the country's imports in 1980. Thus Egypt has not been keeping up with world trends, especially when compared with countries such as Mexico, whose exports in 2001 were 8.8 times its exports in 1980, and Turkey, which in 2001 exported goods worth 10.72 times its exports in 1980.

Another measure of involvement in international trade is the ratio of exports plus imports to GDP. Figure 2-3 presents this variable for several countries. The ratio of total trade to GDP was only 19 percent for Egypt compared with much higher percentages for a number of other countries. Part of the reason for this was overvaluation of the Egyptian pound, which resulted in GDP being overvalued in U.S. dollars, but even in 2003, after devaluation, the ratio was still only 35 percent. However, Egypt's total trade in both goods and services equals 56 percent of GDP, showing the importance of services to the Egyptian economy.

Figure 2-3
Trade in Goods/GDP, Selected Countries, 2000



Egypt's major trading partners are shown in Table 2-3. This table shows that the United States is Egypt's most important export destination and the European Union is the most important source of imports. The Arab states are also substantial trading partners.

Table 2-3
Egypt's Main Trading Partners

	Exports ($ million)			Imports ($million)		
Country or Region	**2000/01**	**2001/02**	**2002/03**	**2000/01**	**2001/02**	**2002/03**
European Union	2,007.2	2,099.2	2,796.9	6,145.1	5,296.6	5,108.6
Other Europe	322.8	378.8	377.1	1,266.9	1,322.7	1,365.5
United States	2,889.2	2,621.1	3,056.9	4,414.9	3,684	3,799.3
Arab countries	816.7	942.7	934.2	754.3	847.5	866.3
African countries	41.1	64.4	73.6	124.5	132	103.1
Other	1,001.2	1,014.6	966.5	3,735.6	3,354.5	3,536.2
Total	7,078.2	7,120.8	8,205.2	16,441.3	14,637.3	14,779
%						
European Union	28.4	29.5	34.1	37.4	36.2	34.6
Other Europe	4.6	5.3	4.6	7.7	9.0	9.2
United States	40.8	36.8	37.3	26.9	25.2	25.7
Arab countries	11.5	13.2	11.4	4.6	5.8	5.9
African countries	0.6	0.9	0.9	0.8	0.3	0.7
Other	14.1	14.2	11.8	22.7	22.9	23.9
Total	100.0	100.0	100.0	100	100	100

The composition of Egypt's exports and imports is shown in Table 2-4. Egypt's exports are relatively well balanced between raw materials (including petroleum) and finished goods. Its imports, however, are heavily concentrated in intermediate and capital goods, followed by consumer goods and then raw materials. Together with relatively constant earnings from petroleum exports, tourism, the Suez Canal, and worker remittances, this emphasis on imports of producer goods suggests low responsiveness of the balance of payments to changes in prices and the exchange rate. Also of note is the growing importance of re-exports and exports from free trade zones.

Table 2-4
Composition of Egypt's Trade Flows ($ million)

	1997	1998	1999	2000	2001	2002
EXPORTS						
Fuel	1,721	927	1,286	1,947	1,598	1,530
Raw Materials	191	237	206	225	223	282
Semi-finished Goods	606	524	440	516	575	585
Finished Goods	1,228	1,264	1,210	1,697	1,245	1,537
Free Zones and Re-exports	74	142	198	1,44	296	433
IMPORTS						
Fuel	214	314	510	1,022	578	440
Raw Materials	1,707	2,168	1179	1,704	1,657	1,850
Intermediate Goods	5,636	7,400	7,142	5,607	5,146	4,861
Capital Goods	3,339	2,858	2,812	2,535	2,006	1,638
Consumer Goods	2,337	2,680	2,645	2,528	2,394	2,500
Free zones	--	1,082	730	619	859	1,235

SOURCE: CAPMAS, Exchange Rate C.B.E.

MACROECONOMIC AND TRADE POLICY REFORM

In 1991, Egypt undertook the IMF's Economic Reform and Structural Adjustment Program, which initiated macroeconomic stabilization policies that addressed high inflation, large fiscal deficits, foreign debt burden, and balance of payments and foreign exchange pressures. Through the program (implemented 1991–1996), and aided by debt relief and rescheduling, Egypt managed to cut inflation from more than 20 percent to close to 3 percent and to reduce fiscal deficits from about 15 percent of GDP to as low as 1 percent. Currency devaluation and access to foreign resources, together with enhanced confidence in the economy, allowed Egypt to accumulate reserves of foreign currency after years of foreign exchange reserves covering less than six months' worth of imports. Foreign debt fell from more than 100 percent of GDP in the second half of the 1980s to about 40 percent. As a result, foreign debt service obligations as a percentage of exports were substantially reduced.

In addition to macroeconomic stabilization, Egypt implemented a package of trade reforms that eliminated almost all nontariff barriers and substantially reduced tariffs and made them more uniform. Through its WTO Uruguay Round obligations, Egypt bound 98 percent of its tariffs and agreed to a schedule of phased reductions during the period 1995–2005. Under the WTO Agreement on Textiles and Clothing, Egypt also committed to eliminating its ban on imports of textiles by 1998 and of clothing by 2002.

Egypt also unilaterally reduced applied tariffs during the 1991–1998 period, cutting import-weighted average tariffs by 50 percent. Tariff reductions targeted, in particular, tariff peaks,

cutting the highest tariffs on imports from more than 100 percent to 40 percent, with the exception of poultry, tobacco products, alcoholic beverages, and automobiles. As a result, the import-weighted average tariff reached 12 percent after the most recent tariff reductions were introduced in January 2004. These reductions, in addition to fulfilling Egypt's commitment to tariff bindings on imports of garments and clothing as part of the ATC, also introduced tariff reductions implementing Egypt's International Technology Agreement.

CURRENT CHALLENGES

The Egyptian economy faces a number of challenges, including the volatility of foreign exchange earnings; population growth, unemployment, and limited expansion of agriculture; and private sector growth and reduction of the public sector.

Volatility of Foreign Exchange Resources

Despite the improvements that Egypt's balance of payments exhibited during and after the Economic Reform and Structural Adjustment Program, as compared to the late 1980s, structural weaknesses in the country's sources of foreign currency make the account volatile and vulnerable to international, regional, and domestic shocks. The main weakness in the balance of payments is the chronic trade balance deficit, which reached its peak of $12.5 billion in 1998/99 as a result of the depreciation of East Asian currencies and the surge of cheap imports from that region. But even after recovery of the East Asian economies, Egypt's trade account was, and still is, persistently in deficit. Furthermore, 30–40 percent of total export proceeds are oil exports, subject to fluctuations in international oil prices. Suez Canal receipts and remittances usually move in the same direction as oil prices, falling when oil exports decline, exacerbating the trade account deficit. Tourism revenues are also not stable. Any shock to tourism produces an immediate reduction in the flow of tourists and size of revenues, and it may take years for revenues to return to previous levels. Thus, in a good year, Egypt's services exports cover the trade account deficit, but when any of these sources is adversely affected, it is likely that a deficit in the trade account will become a current account deficit.

Population Growth, Unemployment, and Limited Expansion of Agriculture

Agricultural expansion is constrained by the limited cultivation area and competition of crops for available land and water along the River Nile. Even if agricultural supply constraints are overcome, agricultural exports face restricted market access in many developed economies. Because of this, Egypt's agriculture will not be able to absorb many additional workers coming into the labor force as population increases. In addition, underemployment in agriculture is a common feature, which means that with better wages and employment opportunities in other activities such as manufacturing and services, there is likely to be net emigration from agriculture to these sectors.

Private Sector Growth and Reduction of the Public Sector

Egypt's efforts to encourage the private sector started with the Open Door Policy in 1974 and resulted in new laws and policies, ending with the current draft of the New Investment Law. These efforts paid off and enhanced the participation of private firms in many areas of economic activity, moving the country from a socialist economy, where most economic activity was owned and regulated by the government, to an economy where more than 70 percent of economic activity is in the private sector.

Creating the right environment for the growth of a strong private sector that is export oriented, diversified, and produces in line with Egypt's competitive advantage is one of the key challenges facing Egyptian policymakers at this stage of the country's economic development. Parallel to that must be programs that aim to privatize remaining public sector firms. The problem is that most of the firms that have been privatized were profitable to begin with, and those that remain are inefficient and employ too many workers to operate profitably. Yet they are burdened with the social responsibility of providing employment. In the long run, reducing the role of the public sector will require both a vibrant, expanding private sector and innovative solutions to the problem of the remaining public enterprises.

Distinguishing Characteristics of Egypt's Economy

A number of distinguishing characteristics of the Egyptian economy should be taken into account in identifying Egypt's comparative advantage in international trade. On the positive side, Egypt has its rich water resources, reserves of oil and natural gas, proximity to Europe and the Gulf, control over the Suez Canal, rich cultural heritage, and large population of well-educated people. Less favorable characteristics include growing population pressure on limited land and water resources, high unemployment, substantial poverty and illiteracy, and a legacy of socialist bureaucracy and public sector ownership.

WATER RESOURCES AND GROWING POPULATION PRESSURE

The flooding of the Nile River—the largest river in the world—presented the Egyptian people with a unique opportunity to develop the earliest civilization on the planet. Although the Nile no longer floods as it once did because of construction of the high dam at Aswan, many of the distinguishing characteristics of the Egyptian economy are still derived from Egypt's long history based on development of this resource.

Development of Egypt's agriculture along the Nile River and in its delta took place primarily on small farms. This was especially true after land reform under President Nasser redistributed to small farmers land that had been feudally owned. By 1995, average land holdings were about 1.5 *feddans* (0.56 hectares), and 96 percent of all landholders owned less than 5 *feddans*. Although this extreme fragmentation of the land is not as great as it seems—because of the possibility of growing two or three crops a year—the inefficiency that

fragmentation creates for agricultural modernization has encouraged the acquisition of land by larger landholders (Ibrahim and Ibrahim 2003, 115–20).

From the time of ancient Egypt, major crops cultivated on these farms have included wheat, beans, onions, garlic, and *bersim* (fodder). The Arabs introduced rice and sugar cane, as well as various fruit trees. Maize was first cultivated in Ottoman times. Vegetables are also important today. Once permanent irrigation, as opposed to flood recession agriculture, was established by Mohammed Ali in the middle of the nineteenth century, cotton was introduced into the Delta region and soon became Egypt's most important export crop. Soil and climate conditions are particularly suitable for growing Egypt's long and extra-long staple cotton, which commands a substantial premium on the world market.

Without the Nile River, Egypt would be largely a desert, unable to support anywhere near its current population. With the Nile, Egypt has not only an important water resource but also rich alluvial soils that have been deposited in the river valley and delta during many millennia. With construction of the dam at Aswan, which was completed in 1971, more water is available downstream because the dam stores water during the flood season, which is released during the dry season. This has made it possible to cultivate not just one, but two or three crops a year. Despite this, a growing population is putting great pressure on Egypt's water resources, making it imperative to allocate these efficiently.

This Egypt has not always done. Within the Nile Valley and delta, water is distributed free of charge through a system of irrigation and drainage canals maintained by the state. Although water is a scarce resource, the absence of water charges means that farmers have no incentive to use it efficiently. This has encouraged the production of low-value crops that use a lot of water, such as flooded paddy rice, in place of those that use water more economically, such as high-value flowers, fruits, and vegetables.

In addition to cultivation on old, formerly flooded, lands, the government of Egypt has encouraged the development of new lands on the edges of or outside the Nile Valley and Delta. Here water is either diverted from the Nile with long canals or is pumped from the subsoil. Experience with this development has not been encouraging. Costs have been high, local populations have been displaced, productivity has been low, and lack of water and salinization have created significant problems (Ibrahim and Ibrahim 2003, 140–53). Furthermore, the cost of developing this land and bringing it into cultivation appear to be rising with movement towards less-accessible areas. Consequently, any future strategy for Egypt must take into account the rising cost of water.

The fact that water resources in Egypt are limited and that expanding the use of land depends critically on the availability of these resources, subject to rising marginal costs, implies that Egypt's growing population will increasingly have to find employment outside agriculture. Otherwise the productivity of labor in agriculture will continue to fall. Thus far, however, the number of jobs outside agriculture has not risen at a rate rapid enough to absorb the growing work force, resulting in rising unemployment and falling real wages for a large part of the population.

OIL AND NATURAL GAS

The oil and natural gas industry is one of Egypt's most flourishing industries. Petroleum accounts for 8 percent of GDP and about 40 percent of Egypt's exports. The industry is one of the four most important sources of foreign exchange for Egypt, but fluctuations in world prices can have a significantly destabilizing effect on the balance of trade. Although Egypt's reserves of oil are limited and could lead to Egypt's becoming a net petroleum importer by 2005–2010, its reserves of natural gas may be a high as 120 trillion cubic feet. Production of natural gas will not only supply the domestic economy and increase exports but also contribute to the development of Egypt's petrochemical industry (American Chamber of Commerce in Egypt 2003).

Prices of petroleum products and natural gas in the domestic market have been fixed for 10 years except for a slight increase in 1997 of the price of fuel oil and the price of natural gas for industry. The result is domestic prices that may be as much as five times lower than world market prices and 10 times lower than prices in neighboring countries. These low prices are subsidized by the state, which imposes a significant burden on the government's budget. It also encourages excessive consumption and hinders development of the sector (American Chamber of Commerce in Egypt 2003, 43).

GEOGRAPHICAL LOCATION

Egypt benefits enormously from its proximity to Europe and the Middle East, especially the Gulf—both areas of significant markets and expanding demand. The European Union is one of the largest markets for fresh horticultural products in the world, and Egypt's climate is suitable to the production of many of these products. Costs and timing can be competitive during seasonal windows of opportunity (World Bank 2001, ii). Egypt also has the advantage of potentially low transport costs to Europe and the Middle East for shipment of goods by sea and by air, and for travel to Egypt by tourists.

The Suez Canal was built 1859–69 to link the Red and Mediterranean Seas. Revenues earned for use of this canal amount to close to $2 billion and are Egypt's third most important source of foreign exchange. Despite the arrival in the 1960s of supertankers, which bypassed the Suez Canal, net tonnage passing through the canal and the revenues generated have increased. However, dues have had to be reduced to remain competitive with ships traveling around the Cape of Good Hope (Ibrahim and Ibrahim 2003, 63-64).

Egypt enjoys the advantages of its cultural proximity to other Arab states. This is important in education, entertainment, information technology, and other fields where products are language-specific.

EGYPTIAN CULTURE

Egypt's long history of civilization in the Nile River basin has left abundant treasures of great artistic and historical interest. This has been the foundation for one of Egypt's most

important sources of foreign exchange—tourism, which has boomed ever since Napoleon's invasion in 1798–1801 revealed to Western Europe what a priceless treasure Egypt was. More than five million tourists now visit Egypt every year (Ibrahim and Ibrahim 2003, 173–175). Not only does tourism bring in income and foreign exchange, it also creates a great deal of employment because the tourist sector is very labor intensive.

The major problem facing the tourist industry is volatility caused by political instability in the Middle East and the threat of terrorist attacks in Egypt. The latter threat has been reduced since the attack on tourists in Luxor in 1997, but the former is still present. An important question is the extent to which entry into FTAs with the European Union, the United States, and other partners will help to assure tourists of safety in traveling to Egypt.

HIGHER EDUCATION

Egypt benefits from a relatively large university-trained population. There are at least 13 public universities and about as many higher technical institutes in Egypt. Admission to programs in engineering, architecture, pharmacology, medicine, and veterinarian medicine are particularly competitive. This gives Egypt a large pool of educated professionals who can fill positions in management and technical areas. The pool, in fact, is larger than the number of jobs available, so many of these people are unemployed. This is partly because the quality of higher education is not what it could be. There are too many students in relation to the financial resources that are available, and too much emphasis on quantity rather than quality (Ibrahim and Ibrahim 2003, 104–106).

Overspending on higher education also results in too few financial resources being devoted to primary and secondary education. In 1998 the illiteracy rate in Egypt was 46.5 percent. Many children do not attend school because their parents cannot afford schoolbooks and uniforms or because the children need to work to earn income for the family. Those that do attend school face classes of as many as 60 students. Teachers are underpaid and overworked. Education in professional schools is neither up to date nor adapted to the needs of the labor market, so that businesses have to train their own personnel. One result of all this is a tendency for private education to play an increasingly important role. This results in education that is better adapted to the needs of the labor market, but it also tends to exacerbate class differences (Ibrahim and Ibrahim 2003, 105-09).

One of the consequences of Egypt's relative abundance of educated professionals is that many of these people have migrated to other areas in the Middle East, where demand for their talents is greater and where they earn higher salaries. This results in substantial remittances being transmitted back to Egypt, making this a major source of foreign exchange. However, two disadvantages are associated with this phenomenon. First, it is often the best and brightest who emigrate, depriving the Egyptian economy of their talents. Second, there is some instability associated with this form of emigration, especially given the uncertainty of the political and security situation in the Middle East. Political or economic crises in neighboring countries have at times led to the return of large numbers of Egyptian workers, whom it has been difficult to absorb into the local economy.

SOCIALISM AND ITS AFTERMATH

Egyptian industry experienced its first phase of modernization during the early nineteenth century, when Mohammed Ali established a modern arms industry to add to the existing textile and food processing industries. Following British occupation, which destroyed much of this industry because it competed with that of Britain, worldwide recession during the 1930s presented Egypt with an opportunity to re-establish and expand its industrial sector. This was achieved in part through the imposition of higher tariffs on final products than on raw materials and intermediate inputs. With the discovery and development during the 1930s of petroleum, Egypt was able to meet all its energy demands. This strategy of self-sufficiency and substitution of local production for imports continued through and after World War II (Ibrahim and Ibrahim 2003, 157–160).

With the coming to power of President Nasser, state intervention increased in the industrial sector, especially in heavy industry. The socialist laws of 1961 gave the state full control over industry. The size of state-owned industrial establishments increased considerably until these dominated many subsectors of the economy. Growth of the industrial sector during the first half of the 1960s was almost 9 percent, but during the second half of the decade, a combination of the wars with Israel and Yemen and the pursuit of socialist management principles resulted in a substantial decline in the rate of growth (Ibrahim and Ibrahim 2003, 160–161).

Despite liberalization of the economy under President Sadat and President Mubarak, the period of socialism left its mark on Egypt's economy. Although there have been efforts towards privatization, the public sector still accounts for roughly three quarters of industrial employment. Despite efforts to transfer control of state-owned enterprises from government ministries to independent holding companies, with full financial and managerial accountability, the pace of privatization has slowed. Many of the more profitable companies have been sold off, and the government is reluctant to add to unemployment by liquidating the rest. The government is also concerned about loosening its control of strategic industries and utilities such as petroleum, telecommunications, electrical power, air transport, iron and steel, aluminum, flour mills, pharmaceuticals, banking, and insurance (Economist Intelligence Unit 2003, 10–13). This has slowed the ability of these sectors to adapt to Egypt's changing international trade regime.

In addition to the importance of public sector ownership during the period of socialism under President Nasser, the private sector was also heavily regulated through price regulation, trade and exchange controls, and a myriad of authorizations that were required. This resulted in a bureaucracy that was imbued with a spirit of regulation and control rather than assisting the private sector to develop. Too often, the private sector was thought to be the enemy of the state. Although liberalization programs have removed many of these regulations and controls, the habits of government bureaucracy are not easily changed. Wherever regulation and control exist, they are likely to be abused. Many examples are cited in the section dealing with the problems of individual subsectors.

Egypt's Comparative Advantage in the Global Economy

To assess Egypt's comparative advantage in the global economy, we first examine how that economy has been evolving and what this implies about the role that Egypt might play. We then examine each type of activities in which Egypt is involved, or could be involved, and whether these are activities in which Egypt is likely to have a competitive advantage.

CHANGING GLOBAL ECONOMY

"Globalization" has come to symbolize many different aspects of world integration resulting from "reduced costs of transport, lower trade barriers, faster communication of ideas, rising capital flows, and intensifying pressure for migration" (World Bank 2002b, 1). Globalization can be divided into three waves. The first occurred from 1870 to 1914 and involved reduced import tariffs and declining costs of overland and maritime transportation, which opened up vast areas of land and other natural resources, in turn stimulating massive migration. During this period international trade was characterized by the exchange of natural resource-based products for manufactured goods. Improvements in financial market institutions coupled with the development of telegraph communication facilitated large flows of capital, which meant that living standards in the regions of new settlement tended to rise, as did those in the regions of emigration because of reduced pressure on the resource base. This all came to an end with World War I and the retreat to nationalism and protective trade and exchange rate barriers, which characterized the period 1914-45 (2002b, 24–28).

The second phase of globalization took place from 1945 until about 1980. This wave was made possible because of cooperation among nations in establishing international institutions such as the General Agreement on Tariffs and Trade and the International Monetary Fund, which led to the multilateral reduction of barriers to trade and capital flows. The lowering of these barriers was selective, however, in that it took place more among developed countries of the North than among developing nations of the South or between the North and the South. The reduction of barriers to trade and capital flows was accompanied by a further decline in the cost of transportation. However, the resulting restoration of the pre-1914 pattern of trade between North and South, whereby the South exported land-intensive primary commodities in exchange for manufactured goods from the North, was not accompanied by similar labor and capital flows. Furthermore, the pattern of trade among developed countries was not based so much on traditional concepts of comparative advantage as it depended on exploitation of economies of agglomeration and scale, which were almost accidental in their origin (World Bank 2002b, 28–29).

These economies of agglomeration and scale, which formed the primary basis for trade in manufactured goods during the second wave of globalization and remain very important today, resulted from the creation of clusters of manufacturing firms, skills markets, input suppliers, and supporting activities in such areas as finance, advertising, marketing, and research and development. The particular product produced by each cluster might be a

historical accident, but once the cluster was formed, it was able to retain its advantages over potential competitors. This made it particularly difficult for developing countries to break into trade in manufactures. Those that were successful, especially in Asia, depended on low labor costs to offset the advantages of agglomeration and scale that had already been achieved by the industrial nations. This success then enabled these developing nations, in turn, to benefit from the same economies as clusters of labor-intensive, export-oriented firms began to form.

The world is now in a third wave of globalization, a wave in which some developing nations are participating very actively and others almost not at all. This wave began about 1980 as a number of developing nations began to dismantle protective tariffs, import quotas, and exchange controls. It soon became apparent, however, that a more open trade and exchange rate policy environment was a necessary but not sufficient condition for a country to benefit from globalization. The ways in which openness might positively influence economic growth were several.

> The reforms have been designed to induce growth through the reallocation of resources away from inefficient production of import-competing goods and non-tradables and towards the production of goods for export. This should lead to static economic gains resulting from exploitation of comparative advantage and economies of scale. There are also a number of dynamic ways in which trade contributes to economic growth. These include having trade and associated investment serve as a conduit for technological transfer, increasing the efficiency of enterprises forced to compete to a greater extent in foreign and domestic markets, expanding the commercial and managerial competence of entrepreneurs, augmenting the skills of the work force, creating a market for labor in the face of growing population pressure, and increasing foreign exchange earnings that can be used to import technology and capital equipment. In addition, openness to trade may increase the potential for learning and technological spillovers across firms (Romer 1986). Finally, the reforms may impact growth directly by reducing the importance of rent-seeking and lowering the cost of domestic marketing. (Stryker 1997, 3)

A number of countries, especially in East and Southeast Asia, benefited very much from greater openness, which enabled them to take advantage of their low labor costs and to expand their exports of manufactured goods, and ultimately even services. Policy reform in the developing countries was coupled with progress in reducing tariffs in the industrial nations, although substantial discrimination against imports from developing countries still remained. Trade was also facilitated by progress in transport and communication, which made it possible to manage geographically dispersed supply chains. However, distance remained important because of innovations such as "just-in-time" delivery, which meant that economies of agglomeration continued to be critical. By the end of the millennium, in fact, economic activity was more geographically concentrated that ever, largely in areas with good access to the sea. This meant that populations had to be willing to migrate to where the jobs were if their incomes were to rise (World Bank 2002b, 31–33).

The more successful developing countries not only undertook major policy reforms but also invested in the complementary infrastructure, skills, and institutions that modern production and trade requires. They constructed transportation and communications

networks, educated their populations, liberalized their investment regimes, stabilized their macroeconomies, and modernized their legal, regulatory, and judicial systems. The result was rapid acceleration of economic growth in these countries from the 1970s through most of the 1990s (World Bank 2002b, 34–36).

In many other countries, these positive benefits did not occur. Many reasons have been cited for this poor performance, including the failure of reforms to be fully implemented or sustained, poor geographical location, lack of physical infrastructure, weak educational systems, inadequate legal and regulatory systems, weak financial and marketing structures, excessive administrative controls, oppressive tax systems, and absence of fiscal discipline (Stryker 1997). As a result, by the end of the millennium, these "least-developed countries" (LDCs), with a total population of about 2 billion, mostly in Africa and the former Soviet Union, risked being seriously marginalized. Indeed, given the importance of economies of agglomeration and scale, the question arose as to whether these economies would ever be able to catch up.

The situation has been aggravated by some unique characteristics of globalization's third wave. One is the enormously rapid pace of change in information and communications technology (ICT), which has enabled more and more people "to reach farther and farther, into more and more countries, faster and faster, deeper and deeper, cheaper and cheaper than ever before in history." (Friedman 2000, 47) This has tended to give many countries the opportunity to participate as producers of goods and services at some stage in the value chain for various products because of the ability of suppliers to control, manage, and communicate across links in the chain. Transportation costs have remained critical. Countries with poor location, inadequate infrastructure, and weak institutions (e.g., transport and communications regulatory regimes) have been severely disadvantaged. Furthermore, the importance of new ICT technology has put a premium on education and training, in which many of the LDCs are relatively weak.

Another characteristic of the third wave results from changes in capital flows. Since 1980 international capital markets have been substantially liberalized through the elimination or reduction of controls on capital flows, more liberal investment regimes, and a number of risk-reducing financial innovations. Total capital flows to developing countries increased from $28 billion in the 1970s to $306 billion in 1997. The composition of these flows also changed in that the share of official flows more than halved whereas that of private capital flows increased dramatically. Within the latter category, bank lending declined while portfolio investment and FDI increased (World Bank 2002b, 42). This was facilitated by the establishment of a number of international mutual and pension funds and by the development of various instruments for reducing risk to lenders and making this risk more marketable. This included the development of the junk bond market, the creation of Brady bonds which permitted developing country debt to be bought and sold on secondary markets, and the issuing by developing country governments of bonds denominated in U.S. dollars and other major currencies (Friedman 2000, 53–60). These developments bypassed many developing countries by. In fact, they actually lost because of the decline in official flows, the fact that capital outflows were facilitated by liberalization of capital markets, and

the tendency for FDI, their most important source of foreign capital, to be directed elsewhere. This was all the more serious because FDI brings with it not only capital but also advanced technology and access to international markets (World Bank 2002b, 43).

Flows of low-skilled labor to advanced countries remained restricted while flows of skilled labor contributed to "brain drain." Nevertheless, pressure for migration of low-skilled labor continued to build as wage differentials widened and knowledge of opportunities increased. The result was a substantial growth in both legal and illegal migration from least developed to advanced countries. This not only relieved wage pressure in poor countries but also contributed to reverse flows of remittances, investment, and even technology transfer (World Bank 2002b, 43–46).

Least developed countries have been constrained from participating in the global economy because of their lack of infrastructure, education, and supporting institutions; because of their disadvantageous position vis-à-vis the early starters; and because of the very nature of the third wave. But they have also suffered because the rules of the global economy are rigged against them. For example, tariff peaks and tariff escalation in industrial countries discriminate against developing country exports. Agricultural subsidies lower prices on world markets, hurting developing country farmers. Intellectual property rights are protected for rich country enterprises in ways that injure the developing world.

EGYPT'S ECONOMY IN RELATION TO THREE WAVES OF GLOBALIZATION

Although Egypt is not a least-developed country, we can draw a number of lessons from the preceding analysis. One is that it is easy to get stuck exporting primary products in exchange for manufactured goods—the pattern of trade that characterized the first wave of globalization. Second, the labor-intensive route to export growth is not as easy as it used to be. A number of Asian countries took advantage of that route during the second wave and have now consolidated their gains to such an extent that they, too, benefit from significant economies of agglomeration and scale, making it difficult to compete with them in these markets. Third, Egypt stands to reap significant benefits from economies of agglomeration and scale in industries in which it has achieved a bit of a head start. Finally, the third wave of globalization provides abundant evidence of the importance of location, education and training, and investment in transportation and ICT—all areas in which Egypt has a significant advantage.

To examine Egypt's economy in relation to the three waves of globalization, let's divide the economy into four broad sectors:

- ***Rent-bearing sector***, in which Egypt's comparative advantage is determined largely by its environmental, natural resource, locational, and cultural assets. This was the sector in which Egypt specialized during the first wave—with the production and export of cotton and the revenue generated by the Suez Canal. This sector expanded significantly with the discovery of petroleum and the development of tourism. Additional industries that

benefit from the availability of low-cost energy include nitrogen fertilizer and aluminum. Horticulture is another industry in which Egypt benefits from excellent growing conditions and proximity to major markets.

- ***Labor-intensive sector***, in which Egypt takes advantage of its low wages. One example is the clothing industry. This is a sector in which a number of Asian countries expanded their exports during the second wave. Some, such as China, continue to do so. Competition, however, has increased substantially during the third wave and is likely to increase even more when the Clothing and Textile Agreement expires the end of 2004.
- ***Economies-of-agglomeration and scale sector,*** in which Egypt has some experience owing to its policies to promote industrialization from 1930–1965 in such industries as iron and steel production and pharmaceuticals.
- ***Human capital-intensive sector***, in which Egypt benefits from its large numbers of university graduates. Important examples of comparative advantage here are information technology and financial services. Remittances from Egyptians living abroad are another way in which this sector has contributed to the Egyptian economy. This is the sector that has grown enormously in importance throughout the world during the third wave.

Each of these sectors offers the Egyptian economy opportunities and challenges.

Rent-Bearing Sector

Egypt may almost be referred to as a rentier state because of the importance of rent-bearing industries in its economy—petroleum, Suez Canal, tourism, cotton. This implies that returns in these industries are determined largely by price rather than cost For example, the cost of extracting oil and natural gas is relatively low in relation to world market prices for these commodities. The difference is a "rent" to whoever owns these resources in the ground—in this case, the Egyptian state. Similarly, the revenue earned from the Suez Canal can be considered largely a rent resulting from past investment and the location of Egypt with respect to transportation routes. Cotton and horticultural crops also earn rents based on the ideal climate and soil conditions under which they are grown, as well as proximity to the European and Middle Eastern markets. Even tourism earns rents because of Egypt's rich cultural heritage and desirable seaside resources.

This is not to say that all the return on these activities is in the form of rent. Exploiting natural resources, environment, location, and cultural heritage requires investments, purchase of materials and equipment, and payments to workers and managers. But the fixed inputs—natural resources, environment, location, culture—are sufficiently important that a large part of the return to these inputs is in the form of rents.

This implies that the output of these activities is not very sensitive to price. Because these activities are very important in generating foreign exchange for Egypt, this implies that the supply of foreign exchange is to a large extent fixed independently of the costs of production. Depending on the demand for foreign exchange, this can result in a real exchange rate is so overvalued that other sectors have a hard time competing on the world

market. This phenomenon is called "Dutch Disease" after the appreciation of the real exchange rate that occurred in the Netherlands after the discovery of oil in the North Sea. For Egypt, this means that it may discourage the expansion of exports and encourage the expansion of imports outside the rent-bearing sector independent of trade policy.

Labor-intensive Sector

With its widespread unemployment and low wages, Egypt would seem to be a natural candidate to follow the Asian countries in expanding exports of labor-intensive industries such as garments. However, as the preceding analysis suggests, countries following this path have had problems meeting standards of product specifications, quality control, just-in-time delivery, and a host of other areas. Furthermore, low labor cost is much less an advantage that it was two decades ago in that the share of semi-skilled labor in value added has shrunk.

This does not mean that labor-intensive activities should be ignored. On the contrary, labor-intensive production is one of the best ways to generate employment. Furthermore, if semi-skilled labor can be combined with skills in management, design, quality control, and marketing, then labor-intensive production can be successful and exports of its products can be expanded. Egypt has already shown this in apparel, wood carving, and horticulture. On the other hand, one has to ask why Egypt has not moved up the scale to such industries as electronic assembly and data entry.

Economies of Agglomeration and Scale Sector

Many industries in Egypt have not yet achieved economies of agglomeration and scale. For example, production of ceramic tile—a fairly new industry in which about 12 firms have substituted local production for imports and are expanding their exports—is still limited in size. As a result, it lacks pools of labor with specific skills, rapid availability of specialized repair and other technical services, and stocks of spare parts and specialized inputs that may be required on short notice. Other industries have achieved economies of agglomeration and scale. These include food processing, textiles, metal working, iron and steel, pharmaceuticals, and wooden furniture. It remains to be seen whether these economies can be translated into expanded exports.

Human Capital-intensive Sector

Egypt's abundance of educated professionals implies a comparative advantage in the production and export of certain human capital-intensive goods and services, such as pharmaceuticals, computer services, software programming, and financial services. In addition, such professionals are needed in many other industries to ensure international competitiveness. Examples of such needs include product design, process engineering, marketing, computer systems, and management. In fact, international competition is such that these skills are increasingly making the difference between success and failure. In this respect, Egypt is poised to take advantage of opportunities presented by changes in the

international trade regime. The following subsector analyses provide a number of concrete examples.

REVEALED COMPETITIVE ADVANTAGE ANALYSIS

The analysis of revealed competitive advantage makes use of two measures. The first is the relative rate of change of the value of exports minus the relative rate of change of total world exports during the period 1998-2002. These data are taken from the International Trade Center's TradeMap and are based on mirror images of trade data from Egypt's trading partners. A positive value indicates that Egypt's exports of a particular product are growing more rapidly than world trade in that product, which may indicate that Egypt has a competitive advantage. A negative value suggests that Egypt's exports are growing less rapidly then world trade and that Egypt may have a competitive disadvantage.

The other measure of competitive advantage is the customs duty rate that is applied to Egyptian imports. The higher the rate, the more likely is it that Egypt has a competitive disadvantage and that the industry needs protection.

Data from TradeMap are analyzed at the 4-digit HS Code level to identify products for which exports are substantial and appear to be growing rapidly in relation to world trade or for which there are relatively high rates of protection. In a few instances, products are included because there is a particular interest in them even though their export performance is not very strong and they are not highly protected

Table 2-5 shows value of exports, growth of exports, growth of exports relative to growth of world trade, value of imports, growth of imports, growth of imports relative to growth of world trade, and rate of import duty for a number of agricultural products and processed foods. In some instances, these products are defined at the 6-digit rather than the 4-digit level.

The agricultural products are pretty well confined to fresh fruit and vegetables because this is the subsector demonstrating the best export performance. Within this subsector are two broad types of product: (1) traditional crops such as tomatoes, potatoes, onions, garlic, and oranges, and (2) non-traditional exports such as grapes, strawberries, and other crops. It is clear from Table 2-5 that non-traditional exports have had much better export performance than traditional crops, which are grown primarily for the domestic market. The same can also be said for processed foods, including processed horticultural crops, coffee extracts and preparations, and cane and beet sugar by-products. Poultry exports, on the other hand, are not very great and have been declining.

On the import side, tariffs are generally moderate to fairly high—with one big exception, poultry, which is subject to an 80 percent rate of duty and a ban on imports of poultry offal and limbs. Traditional crops, which appear to be less competitive on the international market than non-traditional crops, are less protected. Except for dried vegetables and food preparation n.e.s., however, imports are either low or non-existent. On the other hand, even

though imports of poultry products are low because of the high duty rate plus the ban on imports of chicken parts, poultry imports have, according to the data, been growing very rapidly.

The same variables are presented in Table 2-6 for cotton, textiles, and clothing. Exports of cotton have been growing relatively slowly. Nevertheless, it is clear that Egypt has a strong competitive advantage in exporting long and very long-staple cotton—either as raw cotton fiber or in some finished form. Cotton yarn exports in 2002 were also large at $129 million. Overall, however, exports of cotton yarn have been declining. Woven cotton fabrics appear to be even less competitive, with exports declining rapidly. On the other hand, carpets and men's and women's suits have been doing very well, demonstrating significant competitive advantage. In fact, exports of clothing and household textiles have been expanding across a relatively broad front, showing considerable overall strength. Imports of most of these products have been relatively modest, probably because specific duties with very high ad valorem equivalents were assessed until recently. This is evidenced by the rapid decline of most clothing imports during the period 1998-2002.

Table 2-7 presents these variables for a number of other industrial products. The first of these shows the rapid growth of exports that has occurred in the marble and ceramic tile industries. These two subsectors have shown remarkable competitiveness on the global market, with exports increasing to a variety of countries. Pharmaceuticals have demonstrated less promise with respect to export markets, but this could change if official retail prices are not raised to allow these firms to recover their costs by selling on the domestic market. Exports of nitrogenous fertilizers are increasing rapidly because energy subsidies have lowered the cost of production. Metals and metal products is also an area of export expansion, perhaps demonstrating the advantages of economies of agglomeration and scale, as well as energy subsidies that benefit aluminum production. One area of particular vulnerability is passenger cars, which receive the benefit of 135 percent tariff protection. Trucks, on the other hand, have a much lower rate of protection and seem to be experiencing some export success. Finally, the furniture and wood products industry is lackluster in its export performance and protectionist in its tariff rates, but this hides significant trends in the industry.

Table 2-5
Exports and Imports of Agricultural Products and Processed Foods

HS Code	Description	Exports			Imports			Tariff Rate (%)
		2002 (US$ million)	Change 1998–2002 % pa	Change 1998–2002 relative to world (%)	2002 (US$ million)	Change 1998–2002 % pa	Change 1998–2002 relative to world (%)	
FRESH FRUITS AND VEGETABLES								
070190	Potatoes, fresh or chilled	34.04	0	2	0.45	n/a	n/a	20
070200	Tomatoes, fresh or chilled	1.43	-8	-11	n/a	n/a	n/a	20
0703	Onions, garlic and leeks, fresh or chilled	22.91	10	8	1.75	408%	406	20
070820	Beans, shelled or unshelled, fresh or chilled	16.54	0	-1	0.71	n/a	n/a	20
0709	Other vegetables, fresh or chilled	5.52	30	25	0.04	19%	14	20
0710	Frozen vegetables	12.19	6	3	0.03	n/a	n/a	30
0712	Dried vegetables	15.22	-4	-3	0.15	-9%	-8	30
0713	Dried vegetables, shelled	13.27	5	1	96.49	2%	-2	1
071420	Sweet potatoes, fresh or dried	2.39	16	8	n/a	n/a	n/a	30
080510	Oranges, fresh or dried	65.61	7	5	0.03	n/a	n/a	40
080610	Grapes, fresh	14.26	35	28	n/a	n/a	n/a	40
081010	Strawberries, fresh	8.60	46	48	n/a	n/a	n/a	40
PROCESSED FOODS								
1703	Molasses	41.47	19	14	n/a	n/a	n/a	30
2005	Prepared or preserved vegetables	3.73	46	45	0.29	26	25	30
2007	Jams, jellies, marmalades	4.37	10	8	4.85	-15	-17	40
2009	Fruit and vegetable juices	7.92	25	25	0.78	-20	-20	40
2101	Coffee extracts and preparations	4.57	20	19	2.00	-8	-9	30
2106	Food preparations	35.67	-7	-10	26.09	0	-3	30
230320	Beet pulp, bagasse, etc	21.97	31	34	n/a	n/a	n/a	5
POULTRY								
0207	Meat & edible offal of poultry meat	0.39	-39	-39	1.22	248	248	80

Table 2-6
Exports and Imports of Cotton, Textiles, and Clothing

HS Code	Description	Exports			Imports			Tariff Rate[a]
		2002 (US$ million))	Change 1998–2002 % p.a.	Change 1998–2002 relative to world (%)	2002 (US$ million)	Change 1998-2002 % p.a.	Change 1998–2002 relative to world (%)	
COTTON								
520100	Cotton, not carded or combed	186.89	1	7	20.38	na	na	exempt
TEXTILES AND CLOTHING								
5205	Cotton yarn	128.88	-5	-8	38.32	-6	-9	12 (30)
5208	Woven cotton fabrics	15.04	-15	-16	17.98	-4	-5	22 (54)
5702	Carpets, not tufted	59.57	6	7	1.62	-14	-13	40
5703	Carpets, tufted	38.43	22	23	0.29	-13	-12	40
6103	Men's suits, knitted or crocheted	34.18	51	46	10.47	4	-1	40 (spec)
6104	Women's suits and dresses, knitted or crocheted	22.43	2	2	13.91	-1	-1	40 (spec)
6105	Men's shirts, knitted or crocheted	26.20	-13	-7	0.24	-43	-37	40 (spec)
6107	Men's underpants, pajamas, bathrobes, etc, knitted	26.09	6	3	0.29	-20	-23	40 (spec)
6108	Women's slips, panties, pajamas, bathrobes etc, knitted	28.90	7	9	21.71	-19	-17	40 (spec)
6109	T-shirts, singlets and other vests, knitted or crocheted	75.92	2	-4	3.86	-14	-20	40 (spec)
6110	Jerseys, pullovers, cardigans, etc, knitted or crocheted	66.81	-4	-9	5.60	-19	-24	40 (spec)
6203	Men's suits, jackets, trousers etc & shorts	102.08	7	6	23.19	-29	-30	40 (spec)
6204	Women's suits, jackets, dresses skirts etc & shorts	117.33	17	12	12.37	-26	-31	40 (spec)
6205	Men's shirts	30.00	-15	-14	3.66	-42	-41	40 (spec)
6302	Bed, table, toilet and kitchen linens	90.02	5	1	0.88	3	-1	35 (spec)

[a] *Figures in parentheses are tariff rates prior to January 21, 2004; (spec) means that specific tariff rates applied, often at very high ad valorum equivalent.*

Table 2-7
Exports and Imports of Other Industry Products

HS Code	Description	Exports			Imports			Tariff Rate (%)
		2002 (US$ million)	Change 1998–2002 % pa	Change 1998–2002 relative to world (%)	2002 (US$ million)	Change 1998–2002 % pa	Change 1998–2002 relative to world (%)	
BUILDING MATERIALS								
2515	Marble, travertine, ecaussine etc,	60.07	63	53	9.96	-11	-21	15
6908	Glazed ceramic flags & paving, hearth/wall tiles; mosaic cube	16.23	40	39	3.30	-22	-23	30
PHARMACEUTICALS								
3004	Medicament mixtures (not 3002, 3005, 3006), put in dosage	24.85	0	-16	191.39	10	-6	10
FERTILIZERS								
3102	Mineral or chemical fertilizers, nitrogenous	123.75	50	45	3.46	12	7	30
METALS AND METAL PRODUCTS								
7208	Flat-rolled products of iron/non-al/s width>/=600mm, hr, not clad	143.22	88	90	1.81	-18	-16	20
7213	Bars & rods, hr, in irreg wound coils, of iron or non-alloy steel	46.83	5	5	224.00	-37	-37	20
7214	Bars & rods of iron/non-al/s, nfw than forged, hr, hd,/hot-extruded	23.64	-43	-42	1.13	-1	0	20
7601	Unwrought aluminum	92.41	16	13	1.91	15	12	20
7606	Aluminum plates, sheets and strip, of a thickness exceeding 0.2mm	60.06	20	20	4.93	-8	-8	30
8544	Insulated wire/cable	42.28	104	101	65.83	-17	-20	30
MOTOR VEHICLES								
870310	Cars (incl. station wagon)	0.45	-27	-32	171.99	-20	-25	135
8704	Trucks, motor vehicles for the transport of goods	1.31	134	131	99.72	-22	-25	40
FURNITURE AND OTHER WOOD PRODUCTS								
9403	Other furniture and parts thereof	30.54	1	-2	18.72	-10	-13	40

3. Trade Policy and the International Trade Regime

Current Trade Regime in Egypt

TARIFF STRUCTURE

In 1981, Egypt's unweighted average tariff was 47.4 percent; by 2002, that was reduced to 20.6 percent (excluding 3,000 percent tariffs on alcoholic beverages). This average tariff may be compared with average tariffs for a number of well-performing exporting countries such as Malaysia (9 percent), Indonesia (9.5 percent), Philippines (10 percent), Turkey (12.5 percent), and Mexico (13 percent). The level of tariffs in Egypt thus continues to be a high, insulating local industry to some extent from import competition and creating a bias in favor of producing for the local market. In addition, several particularly sensitive products have very high tariff peaks. As shown in Table 3-1, the unweighted average tariff on agriculture and food products (excluding alcohol) is 21.5 percent, but when weighted by imports it falls to 5.7 percent. The unweighted average tariff on manufactured imports is 20.4 percent, while the import-weighted tariff on these goods is 14.8 percent.

Within manufacturing, the rates vary significantly. For example, average tariffs on leather and footwear are 30.7 percent (unweighted) and 37.5 percent (weighted), while for processed foods (excluding alcohol) they are 26.5 percent (unweighted) and 8.0 percent (weighted) (Table 3-1). The variance in tariffs applicable to different subsectors and even within a subsector sometimes produces rates of effective protection (i.e., protection on value added) that are significantly higher than nominal tariff rates. The unweighted average tariff on consumer goods is 35.6 percent, on intermediate products 21.4 percent, and on raw materials 14.3 percent.

Table 3-1
Sector Unweighted and 2002-import Weighted Average Tariffs (%)

	HS chapter	Simple average	2002-weighted average
All goods		26.5	12.04
All goods excl. alcohol		20.6	12.00
Agriculture and food	1-23	69.9	5.8
Agriculture and food excl. alcohol		21.5	5.7
Processed foods	16-23	214.0	10.0
Processed foods exc. alcohol		26.5	8.0
Manufacturing	25-97	20.4	14.8
Cotton, textiles and clothing	50-63	28.8	10.5
Pharmaceuticals	30	12.6	13.7
Iron and steel, base metals and articles	72-83	18.0	17.6
Leather and footwear	41-43, 64-67	30.7	37.5
Wood products and furniture	44-47, 94	23.2	13.9
Chemicals excl. pharmaceuticals	28,29, 31-36	17.2	18.0
Building materials, cement, ceramics and glass	68-70	25.9	28.5
Vehicles and parts	87	41.7	25.1

SOURCE: Author's calculations using current tariffs including the most recent amendment to tariffs (Presidential Decree 35/2004).

As Table 3-2 illustrates, while the pattern of protection through nominal tariffs appears to be reflected in roughly the same effective rates of protection for some activities (food processing, footwear, transportation equipment), the nominal rates for other activities is much lower than the effective rate of protection (spinning and weaving, garments). Effective protection, not nominal protection, guides producer decisions regarding the allocation of resources. Cotton ginning and pressing is the only manufacturing activity that is negatively protected, and this is because of industry's distorted price structure. In food processing the effective rate is somewhat lower than the nominal rate of protection because inputs are taxed more heavily than outputs.

For manufactured goods as a whole, the weighted nominal tariffs and effective rates of protection are relatively close (14.8 and 18.6 respectively). Although this is not a very high rate of effective protection, it nevertheless has the effect of protecting manufacturing from foreign competition in the domestic market and creating an anti-export bias in a sector that could be the foundation for Egypt's export expansion and reduction in the volatility characteristic of other sources of foreign exchange, as discussed in Section 2. It also means that we should expect overinvestment in consumer goods assembly and underinvestment in local production of components and raw materials, a feature that is very much reflected in the distribution of Egypt's imports by stage of processing.

Table 3-2
Effective Rates of Protection for Manufacturing Sectors in Egypt (%)

Industry	1991/1992 IO Tables			1998/1999 IO Tables	
	1994	1998	2002	1998	2002
Food processing	8.1	7.4	7.4	5.8	1.5
Cotton ginning and pressing	-8.9	-6.2	-5.9	-11.1	-11.5
Spinning and weaving	50.3	44.9	48.2	36.2	38.4
Garments	82.8	44.3	826		
Garments and footwear				43.9	674.1[a]
Leather products excl. shoes	60.9	38.7	50.8	33.2	43.6
Shoes	94.4	50.4	51.8		
Wood, wood products, excl. furniture	6.1	5.8	9.4		
Furniture	99.0	55.1	53.8		
Wood products incl. furniture				9.1	12.0
Paper and printing	17.1	16.2	16	15.2	15
Chemicals and products, excl. petroleum	9.6	9.5	9.7	9.2	6.9
Rubber, plastic and products	49.6	37	38.1	30.1	31
Porcelain, china, pottery	62	39	38.9		
Glass and products	40	28.9	29.2		
Mineral products, n.e.i.	20.5	17.6	19	20.9	19.6
Iron, steel, other base metals	22.1	16.6	16.8	15.4	12
Machinery and appliances	19.2	14.2	14.3	14.4	11.1
Transportation equipment	54.8	46.7	46.6	45.4	44.6
Unweighted manufacturing average*	37.8	26.4	27.8	18.6	18.6
Dispersion*	31.4	18.5	19.2	15.5	17.4

Note: Average and dispersion are for all industries included in the table excluding clothing

[a] *ERPs for the specific tariffs applied through 2003. Current ERPs should be significantly lower*

Source: Refaat (2003), ECES WP 85, "Trade induced protectionism in Egypt's Manufacturing Sector."

In addition, some industries have tariff peaks. For example, customs duties on poultry remain at 80 percent, offering heavy protection in that industry. Duties on tobacco products are also very high at 85 percent, with minimum duties per kilogram. Finally, the automobile assembly industry is protected by duties as high as 135 percent. All these industries require substantial structural adjustment.

NON-TARIFF BARRIERS TO TRADE

Despite substantial progress in reducing tariffs and eliminating bans on imports, nontariff barriers continue to plague Egypt's trade regime. One such barrier is the complex nature of customs and other clearances for imported goods and some exports. The General Organization for Import and Export Control (GOIEC) was established to be a one-stop shop for clearances other than customs, but this has not eliminated duplicative and in many cases

arbitrary clearances required by the Ministry of Health, the Ministry of Industry, and other agencies. Foreign standards are recognized only when there is no Egyptian standard for the product, and many norms and standards that are meant to be optional are treated as mandatory. Labeling requirements on food products, pharmaceuticals, and textiles are often unnecessary and costly. Sampling of products is sometimes unnecessarily destructive, especially when done on each package of goods (European Commission 2002).

In addition, valuation by Customs is not transparent and classification of goods and rates charged by officials are often arbitrary. Egypt has agreed under WTO to use the transactions/invoice value for customs valuation, but arbitrary markups of 10–30 percent are often applied to invoices because of suspected under-invoicing. In other cases, comparisons are made with end-user prices in the exporting country, which include the value added tax and other taxes not included in the CIF value (European Commission 2002, 12).

An important nontariff barrier is the surtax that Customs charges above the import duty and sales tax. This equals 2 percent on goods subject to an import duty of 5 percent to 29 percent, and 3 percent on goods subject to a duty of 30 percent or more. In addition, all imports are charged a service and inspection fee of 1 percent.

In order to acquire foreign exchange for the importation of raw materials, intermediate products, and capital equipment and spare parts, the importer must submit an application to a bank backed by a pro forma invoice. Products may then be imported only if a letter of credit has been obtained from the approved bank, which sometimes requires a 100 percent cash deposit (European Commission 2002, 8). As a result of these onerous requirements and the lengthy delays that they entail, most companies go to the parallel market for their foreign exchange needs.

Decree 619/98, introduced in November 1998, requires that many consumer goods enter Egypt after having been shipped directly from their country of origin, Rational bulking and transportation of goods may make this very inefficient, and it is seen as a violation of Egypt's commitment to the principle of most favored nation (MFN) treatment and of its obligation not to resort to quantitative restrictions on trade.

In some industries, such as the automotive industry, assemblers enjoy reduced duties on imports to the extent they use locally produced components in their finished products. In the assembly of passenger cars, this requires 45 percent local content. This is in violation of WTO, but the WTO has not been notified (European Commission 2002, 12).

Multilateral, Regional, and Bilateral Agreements

In addition to its unilateral steps in reducing tariff barriers and liberalizing trade, Egypt has undertaken commitments as a member of the WTO and has entered into regional and

bilateral trade agreements. Other regional and bilateral trade agreements are pending. These agreements have in a sense locked in Egypt's commitment to freer trade.

MULTILATERAL AGREEMENTS

Egypt is one of 11 states of 22 in the Arab League to hold WTO membership status.[1] Egypt acceded to the General Agreement on Tariffs and Trade (GATT), the predecessor to the WTO, in 1970.

Uruguay Round of WTO

Egypt joined the WTO on June 30, 1995, making significant reductions in its bound MFN tariff rates in certain areas. As a developing country, Egypt was permitted to spread its Uruguay Round implementation commitments over ten years, with final steps to be taken before the end of 2004. For textiles, for example, base rates of 45 percent on yarns were to be cut to 15 percent and base rates of 60 percent on fabrics were to be reduced to 30 percent. Rates on most garments were bound at 40 percent, and 90 percent tariff rates on carpets were bound at 60 percent.

In other areas of manufacturing, Egypt reduced many of its tariff peaks but nevertheless maintained some of them at relatively high levels. For example, duties on most passenger cars were bound at 135 percent. In agriculture, peak rates of 100 percent were reduced to 80 percent, with poultry as an example, and the 110 percent tariff on tobacco products was reduced to 85 percent. Overall, 98 percent of Egypt's tariffs were bound, and the unweighted average applied tariff was to decline to 37 percent by the end of the implementation period (European Commission 2002, 5).

Under the WTO Agreement on Textiles and Clothing, Egypt committed to eliminating the ban on textile imports by 1998 and on clothing by 2002. Egypt has been the sole Arab country governed by the quotas established under the former Multi-Fibre Arrangement (MFA, now superseded by the ATC). It has never exceeded the quotas imposed by the European Union or the United States under the MFA or ATC. One pending deadline that will affect Egypt, however, is the elimination of all remaining textile quotas under the ATC at the end of 2004.

Under the WTO General Agreement on Trade in Services, Egypt made commitments in construction, tourism, financial services, and international maritime transport. These concessions make it easier for foreign service providers to operate in Egypt. Egypt later signed the Agreement on Information Technology, with a commitment to eliminate most duties on computer equipment by 2005, and all such duties by 2007.

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[1] The other 10 Arab League WTO members are Bahrain, Djibouti, Jordan, Kuwait, Mauritania, Morocco, Oman, Qatar, the United Arab Emirates and Tunisia.

For several years, Egypt has had a program to implement nontariff obligations under its WTO commitments. Specific WTO commitments in this area include adoption of the transactions approach to customs valuation, removal of nontariff barriers, liberalizing foreign investment regulations, and privatizing a number of government-owned businesses.

Egypt has undertaken a major effort to meet its WTO commitments. For example, until recently, Egypt was in violation of many of its bound duty commitments for textiles and apparel, imposing specific duties with very high ad valorem equivalents on many items of apparel. On January 21, 2004, however, these duties were changed to ad valorem rates that meet Egypt's WTO commitments. Among the few remaining deficiencies are the ban on imports of poultry offal and limbs, as well as a few duties that are in excess of bound rates for some dairy products, prepared meats, prepared fish, and industrial chemicals. However, these instances are not numerous in relation to the total number of tariff lines that meet, or in many cases surpass, Egypt's commitments. On the other hand, the nontariff barriers described above are technically in violation of WTO.

The Doha Round of WTO

As part of the Doha Round of WTO negotiations now underway, Egypt is in favor of deepening the liberalization of the agriculture and services sector as part of the "Built-in Agenda." Egypt also favors including "the Singapore issues" (i.e., trade facilitation, transparency in government procurement, investment rules, and competition policy) as part of the comprehensive negotiating round.

Egypt submitted its revised negotiating position on agriculture in March 2001, calling for further liberalization in market access, domestic support, and export competition. Egypt favors eventually eliminating all trade-distorting agriculture sector subsidies. Egypt also calls for the operationalization of commitments made to Net Food-Importing Developing Countries (NFIDCs) and LDCs, for example by creation of a Fund for the Support of NFIDCs and LDCs.

Though it is a major cotton producer and exporter, Egypt has not joined the filing of a formal dispute settlement claim by Brazil or the "Cotton Initiative" sponsored by four West African producers (Benin, Burkina Faso, Chad, and Mali). The Cotton Initiative aims to accelerate reduction in the high levels of U.S. and EU domestic support for cotton production, the main type of trade distortion in the sector. The Initiative would also seek compensation for cotton-producing developing countries. The sponsoring countries want cotton to be kept separate from the agricultural sector negotiations, to ensure that their specific demands are addressed.

REGIONAL AGREEMENTS

Egypt is involved in at least three regional trade agreements. The largest and most ambitious of these is the Common Market for Eastern and Southern Africa (COMESA). Two

others, the Greater Arab Free Trade Agreement (GAFTA) and the Agadir Group, build on bilateral trade agreements between Egypt and other Arab countries. Eventually, Egypt may be part of additional regional agreements such as an EU-Mediterranean Free Trade Area and a United States-Middle East Free Trade Area.

COMESA

The 1994 COMESA accord is an expansion of the 1981 preferential trade area agreement and now includes 20 member states.[2] Since October 2000, COMESA has had a free trade area in place, with Egypt cited as one of the nine countries having achieved a 100 percent reduction of tariffs on imports from other COMESA member countries.[3] To be eligible, products must have at least 45 percent value added content in originating countries.

While free trade exists among nearly half the COMESA members in principle, in practice there remain substantial tariff and nontariff barriers to trade within COMESA. Nevertheless, COMESA's plans call for establishing a customs union by 2004, with a monetary union planned for 2025.

Greater Arab Free Trade Agreement

In 1998, eleven members of the Arab League agreed to establish the GAFTA.[4] Four more countries have since joined.[5] The original plan was to reduce tariffs by 10 percent per year for ten years, arriving at a free trade zone by the end of 2007, but in 2002 the Arab League decided to accelerate progress and achieve zero tariffs on intra-Arab trade by the end of 2005.

According to the American Chamber of Commerce in Egypt, each country under GAFTA has an extensive listing of exceptions, hampering the effectiveness of the deal. Further, rules of origin are not clearly defined and substantial administrative and other nontariff barriers remain. In addition, not all GAFTA members are members of the WTO, which weakens the integration effect of the GAFTA.

Agadir Group or "MAFTA"

Egypt entered negotiations in May 2001 in Agadir, Morocco, on a regional FTA with Jordan, Morocco, and Tunisia. In June 2003, the negotiations were completed, providing for a free trade area among the four countries by 2006. Known to some as the Mediterranean Arab Free Trade Area (MAFTA) the agreement builds on Egypt's existing bilateral agreements with these countries. The agreement also includes provisions on competition policy (such as monopoly law) and establishes a ministerial committee to oversee implementation.

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[2] Angola, Burundi, Comoros, D.R. Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia, Zimbabwe.

[3] The other countries are Mauritius, Madagascar, Zimbabwe, Malawi, Sudan, Kenya, Djibouti, and Zambia. Currently Sudan is not applying 100 percent tariff reduction on imports from Egypt.

[4] Sometimes referred to as the Pan-Arab Free Trade Agreement, or PAFTA.

[5] The other countries participating in the GAFTA are Algeria, Bahrain, Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia and the United Arab Emirates.

BILATERAL AGREEMENTS

Through the end of 2003, Egypt had signed seven bilateral trade agreements, including six with Arab countries and one with the European Union. Negotiation of bilateral FTAs with the United States and with the South Africa Customs Union (SACU) is also being considered.

Agreements with Arab Countries

In recent years, Egypt has signed bilateral agreements with Bahrain, Jordan, Libya, Lebanon, Morocco, and Tunisia. Under these agreements, Egypt receives concessional access for a broad range of products (Table 3-3). The wide range of Egyptian export products now eligible for concessional access suggests that Egypt has a broadly diversified economy with significant manufacturing technology in potential export industries. On the other hand, the bilateral agreements also offer an indication of which industries Egypt is endeavoring to protect (Table 3-4). Finally, Egypt signed an FTA with Iraq in 2001, although the validity of that agreement may now be in doubt. With imports of about $1 billion of Egyptian products in 2001, Iraq had begun to rival Saudi Arabia as Egypt's largest Arab trading partner.

Table 3-3
Egyptian Exports Receiving Concessional Access under Bilateral Trade Deals

Country	Export Item
Jordan	Plant products, minerals and mineral products and chemical industry's products.
Lebanon	Commodities exempted during specific market windows for each individual commodity: Potato, garlic, salt and water melon.
	Commodities exempted all the year round: guava, mango, dates and dried dates.
	Commodities liable to a 25 percent gradual reduction annually: Dairy products, pineapple, kiwi fruit, avocado, papaya, mineral water, gaseous water, varnish, paints, frozen vegetables, prepared vegetables, jams and fruit juices.
Libya	Textile materials and manufactured textile products, foodstuff products.
Morocco	White cement, ammonium nitrate, sodium soleplate, seeds of aromatic plants, tomato paste and ketchup, coke charcoal, gelatin, ceramic pricks, iron bars, sheets, rude aluminum, pumps, air conditioners, farm machinery, motors, vacuum cleaners, electric lamps and tubes, photocopying machines and buttons.
Syria	Glucose, human medicines, inks, cotton yarn not prepared for retail trade, aromatic oils, aluminum sheets, tires, saws, razors, shaving instruments, handles, automobile filters, powder, frozen or liquid soup, plastic syringes dyeing and finishing materials for the textile industry, carton materials for the textile industry, carton components and aluminum containers for filling with gases.
Tunisia	Dried legumes, spices, rice, sugar molasses, human medicines, veterinary medicines, movie films, tires, raw cotton, ceramic pricks, flat glass, aluminum, school books, spinning and weaving equipment, washing machines, pipes, dry batteries, electronic spare parts, railway compartments, musical instruments, fans, medical and surgery furniture, photocopying machines and tractors.

SOURCE: *Egyptian Ministry of Foreign Trade.*

Table 3-4
Egyptian Imports Not Included under Bilateral Trade Agreements

Country	Export Item
Jordan	Textile and garments, automobiles, tobacco and tobacco alternatives, construction steel, edible salt, tomato paste and mineral water
Lebanon	Textile, garments, automobiles, tobacco, alcoholic beverages, poultry meat, cement, wires and cables.
Libya	All commodities are exempt
Morocco	Poultry products, alcoholic beverages, tobacco and tobacco products, textiles and garments, automobiles, iron or steel bars and sheets.
Syria	Data being prepared.
Tunisia	Textiles and manufactured textile products, shoes and shoe parts, ceramics, automobiles, and lorries.

SOURCE: *Egyptian Ministry of Foreign Trade.*

Egypt-EU Association Agreement

The EU is Egypt's largest trading partner, with Italy, Germany, France, and the UK accounting for about 70 percent of Egypt's trade with the EU-15. At present, trade with the EU accounts for about 35 percent of Egypt's exports and 36 percent of its imports. Egypt typically runs a large trade deficit with the EU, importing $4 billion of goods per year with exports at roughly $2.5 billion (see Appendix B for a detailed industry breakdown of Egypt's trade with the EU).

Almost one-half of Egypt's exports to the EU in 2002 were of crude oil and refined petroleum products. Textiles and clothing made up about 14 percent of total exports, while agricultural products, exclusive of cotton, comprised another 9 percent (mainly fresh fruit and vegetables), and cotton lint accounted for 5 percent. Aluminum and its products made up another 5 percent.

Egypt's imports from the EU are much more diversified that its exports there. Main categories of products imported from the EU are power-generating and other machinery (22 percent of imports in 2002), electrical and electronic equipment (12 percent), food and agricultural products (12 percent), metals and metal products (7 percent), and industrial chemicals (5 percent). The EU's agricultural markets are generally considered to be closed to Egyptian products. It was estimated in 2003 that unilateral liberalization of the EU's barriers would result in growth in agricultural exports by Egypt worth 3.26 percent of Egypt's GDP (Radwan and Reiffers 2003). The value of Egypt's wheat imports from the EU alone is about equal to the value of all Egypt's agricultural exports to the EU.

Egypt has had a Cooperation Agreement with the EU governing trade relations since the mid-1970s, offering free access to the EU market for Egypt's industrial products. The EU-Egypt Association Agreement was signed in 2001, with ratification to be completed in 2004. Egypt will provide reciprocal access for EU industrial products during a transitional period of 3-15 years. The agreement calls for elimination of Egypt's tariffs on most finished

products during a 12-year implementation period, though tariff reduction for a few products such as automobiles stretches out over 15 years. Egypt has also committed to eliminating duties on imports of inputs, components, capital goods, and raw materials within 3 years of the FTA coming into force. These products make up roughly half of Egypt's imports from the EU. The Association Agreement establishes temporary safeguard mechanisms in case of import surges. All quantitative restrictions on trade are to be eliminated at the time the agreement comes into force.

For agricultural products, the agreement is much less oriented towards freer trade. The EU will enlarge existing quota volumes for preferential access for Egyptian products to the EU market and expand the number of quota categories from 25 to 108 different products. For example, the EU will operate a two-tiered tariff rate quota for fresh oranges from Egypt whereby oranges will be admitted duty-free up to a quota of 60,000 tons, after which the duty will be 60 percent of the MFN duty rate. Other duty concessions are seasonally restricted, as, for instance, duty-free entry of Egyptian tomatoes into the EU market from 1 November to 31 March. In return, Egypt has agreed to lower duties on selected EU agricultural products subject to quota restrictions, to eliminate duties on some processed agricultural products, and to reduce duties on others. Agriculture sector tariffs are to be reviewed 3 years after the Association Agreement comes into force.

The Association Agreement does not cover liberalization of services, which would be desirable to increase the competitiveness of Egypt's manufacturing sector. However, beyond trade concessions, the agreement does involve broad cooperation in some other areas such as public procurement, intellectual property rights, customs facilitation, competition policy, right of establishment, payments and capital movements, investment, education and training, scientific and technological cooperation, environment, industrial cooperation, standardization and conformity assessment, financial services, agriculture and fisheries, transport, information and telecommunication, energy, tourism, consumer protection,. In addition, the EU and Egypt are aiming to facilitate the employment of Egyptian nationals by European countries. Italy, France, and Spain, for example, are interested in bringing in Egyptian labor for seasonal activities such as agricultural harvesting.

Egypt is also interested in a separate FTA with Switzerland and Norway. Egypt runs a trade deficit with Switzerland, one of its larger trading partners in Europe. Egypt would also like access to the market for potatoes in Norway, which has banned Egyptian potatoes since 1997.

The EU-Egypt Association Agreement is to become a component part of the Euro-Mediterranean Free Trade Area to be put in place by 2010 between the EU-15 and 12 Mediterranean countries (Algeria, Cyprus, Egypt, Gaza and the West Bank, Israel, Jordan, Lebanon, Malta, Morocco, Tunisia, Turkey and Syria).[6] With the December 2003 agreement

[6] These efforts are known as "the Barcelona process."

with Syria concluded, the EU has now signed association agreements with all 12 countries.[7] The Euro-Mediterranean Free Trade Area foresees free trade in manufactured goods and progressive liberalization of trade in agricultural products. To support the poorer Mediterranean partners in their efforts to prepare for expanding trade, the EU offers the MEDA Program, providing support for fiscal, economic, and industrial sector reforms.

Tariff concessions offered by the EU under the Association Agreement with Egypt are subject to rules of origin that are relaxed in relation to those offered under the old Cooperation Agreement. In particular, diagonal cumulation of origin is permitted across the 12 Mediterranean countries mentioned above.[8]

Trade Relations with the United States

Egypt has been progressively improving its trading relationship with the United States since the Camp David Treaty in 1979. With the European Association Agreement now in place, an Egypt-United States FTA would be essential to maintaining equivalent access for U.S. products to Egypt's market. An agreement with Egypt would fit within the context of a United States-Middle East Free Trade Area, which President Bush has proposed establishing by 2013.

The United States is Egypt's largest single bilateral trading partner, accounting for about 12 percent of Egypt's exports and 14 percent of Egypt's imports. Egypt typically runs a trade deficit with the United States, although this narrowed in 2002, with imports from the United States at $2.8 billion and exports to the United States reaching a record $1.4 billion. In 2001, the trade deficit was far greater (imports from the United States were $3.8 billion and exports to the United States were only $852 million), roughly the size of U.S. economic assistance to Egypt under the Economic Support Fund of USAID.

Textiles account for about one-third of Egypt's exports to the United States. Egyptian exports of textiles and apparel have been governed by bilateral quotas under the Agreement on Textiles and Clothing (ATC), which is now being phased out, but Egypt has never in practice reached its quota. Nevertheless, phasing out of the ACT will increase competition for Egypt in the U.S. market from China and other Asian countries. An FTA with the United States could be critical for enabling Egypt to compete with exports of textiles and clothing by China and other Asian countries to the United States once the ATC expires at the end of 2004. For such an agreement to be useful for Egypt, appropriate rules of origin would have to be adopted as part of it.

Petroleum and petroleum products account for 16 percent of Egypt's exports to the United States. Egypt is eligible for the U.S. Generalized System of Preferences (GSP), exporting furniture under the program, among other items. Apart from textiles and apparel, the U.S.

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[7] Building on Cooperation Agreements from the mid-1970s with Algeria, Egypt, Jordan, Lebanon and Syria.
[8] There are some exceptions for Turkey, which are spelled out in detail in the Association Agreement.

market has relatively low barriers facing Egyptian exports, with non-textile tariffs averaging less than 2 percent on Egyptian exports.

Egypt imports mainly agricultural products, intermediate manufacturing inputs, and capital equipment from the United States, with a strong U.S. market share in petroleum sector equipment, transportation equipment, and information technology products. Egypt often imports about a billion dollars in agricultural and food products from the United States, including more than $600 million in cereals (wheat, corn). About $200 million of U.S. agricultural products per year enter Egypt under the Commodity Import Program run by USAID.

The United States is a leading source of foreign investment. According to the American Chamber of Commerce in Egypt, 246 companies operating in Egypt have U.S. capital participation, with FDI valued at $2.2 billion in 1999, two-thirds of this in the petroleum industry. Other areas include textiles, food and beverages, and chemicals.

Egypt already has signed a Trade and Investment Framework Agreement (TIFA) with the United States, similar to TIFAs with Algeria, Bahrain, Morocco, and Tunisia. A TIFA establishes the bilateral framework for expanding trade and addressing trade disputes. Egypt also has signed agreements with the United States on double taxation (1981), bilateral investment (1982), investment incentives (1999), energy technology (1999), and e-commerce (1999).

Potential Free Trade Agreement with the Southern Africa Customs Union

At present Egypt's trade with the SACUas shown in Appendix B, is only $28 million in exports and $21 million in imports. But the potential for expansion is considerable because Egypt and SACU are the two largest markets and sources of supply on the African continent.

SACU, the world's oldest customs union, involves South Africa and the BLNS countries: Botswana, Lesotho, Namibia, and Swaziland. South Africa dominates. The EU, and especially the United Kingdom, is SACU's main export market. Among the leading export products of the SACU countries outside the customs union are diamonds, platinum group metals, meat, fish, textiles, clothing, and sugar and related products. Most of SACU's imports come from the EU, the United States, and other African countries. These consist mainly of machinery, metals, transport equipment, food and beverages, and supplies for the clothing industry (WTO 2003, 3).

South Africa signed a Trade, Development, and Cooperation Agreement (TDCA) with the EU in 1999. This agreement was not concluded with SACU because the BLNS countries are already linked with the EU via the Cotonou Agreement, for which South Africa is not eligible. The TDCA is similar to the EU–Egypt Association Agreement. The agreement is asymmetrical in that South Africa will eliminate trade barriers on about 86 percent of its imports from the EU during a 12-year period whereas the EU will do the same on 95 percent of its imports from South Africa during 10 years, with most of these obligations

being accomplished within 3–6 years. On the South African side, 11 percent of imports from the EU are excluded because of sensitivities. These imports include beef, pork, barley, sugar, some dairy products, petroleum oil, motor components, and passenger vehicles. Except for petroleum products, these are not products that Egypt would likely export to South Africa. Other products are to be only partially liberalized, such as footwear, textiles and clothing, and tires. These products are already subject to high tariffs and could be much more sensitive in a SACU-Egypt FTA. The products not subject to complete liberalization on the EU side are very similar to those of the Egypt–EU Agreement—mostly agricultural products and processed food.

This illustrates that the economies of Egypt and SACU are similar, which means that there is some potential for "trade diversion," with imports from a low- cost third country being diverted to a high-cost partner. Thus, the positive effects of growth in trade following the signing of an FTA would likely occur along relatively narrow product lines within industries that are not easy to predict in advance. This "trade creation" is generally beneficial because it means shifting from high-cost local production to low-cost partner production. The extent to which this would occur depends on a host of factors, such as sensitivity to transport cost, transfer of market information, and economies of agglomeration and scale.

The structure of tariffs and other trade barriers in SACU, though simplified in recent years is still complex and in many cases in violation of WTO. In addition to ad valorem duties, SACU also has specific duties based on quantities and formula duties based on reference prices. In addition, compound and mixed duties combine two or more of these different types of duties. Complex rules of origin involve not only SACU but also the Southern Africa Development Community (SADC), which is establishing a free trade area among nine other countries in addition to those in SACU. A number of these are also members of COMESA, which South Africa is not, adding to the complexity. Despite these complications, an FTA might well stimulate greater investment by South Africans in Egypt, which would be desirable.

South Africa, on behalf of SACU, committed itself in the Uruguay Round to apply tariff quotas to a range of agricultural products, under minimum market access commitments, at maximum rates of 20 percent of the bound rates. However, bound rates are high. It is not clear to what extent Egypt would benefit from this.

Free Trade Agreement with Turkey

Egypt and Turkey are planning negotiations for an FTA that will involve a gradual reduction of customs on industrial and agricultural goods.[9] A fifth round of negotiations took place last summer, where a disagreement arose about the speed of the process. A further examination of foreign exchange policy and customs systems is necessary before the

[9] See www.arabicnews.com.

agreement enters into force. Trade between the two nations declined from $513 million in 2001 to $430 million in 2002. (Al-Ahram Weekly Brief 2003)

Trade Regimes of Major Trading Partners

Egypt's most important trading partners by far are the EU and the United States, which together accounted in 2002–2003 for 71 percent of Egypt's exports and 59 percent of its imports (Ministry of Foreign Trade 2003, 173). Trade with other regions is reasonably diversified.

The post-Uruguay Round international trade regime is characterized by constraints that impede developing nations' access to the markets of OECD member countries, including the EU and the United States. For example, despite a substantial reduction in the average level of tariffs for OECD members, sensitive products still have large peaks in tariff rates. Even though the average level of tariffs in the textile and clothing industry is 8.0 percent in the United States, 26 percent of the tariff lines for knitted or crocheted apparel (HS 61) have tariffs in excess of 15 percent. The problem of tariff peaks is especially important in such industries as red meat, dairy products, cereals, sugar, tobacco, and footwear in the EU, and in tobacco, textiles and clothing, and footwear in the United States (OECD 1999).

Second, tariff escalation discourages the exportation to OECD members of processed products in comparison with those that are unprocessed because the former receive more tariff protection that the latter. Tariff escalation is particularly prevalent in the EU for red meat, sugar, tobacco, and wheat. In the United States, it is especially important for sugar and tobacco. In the EU tariff rates on consumer goods average more than five times their level for capital goods. In the United States the difference is much less (OECD 1999, 44, 144).

Tariffs for most unprocessed and processed agricultural products are also influenced by tariff rate quotas, whereby the importing country allows a certain quota of imports to come into the country at one tariff rate, then raises the rate once that quota is met. Sometimes the quotas apply only in particular seasons when there is not much competition from local producers. Tariffs may be either ad valorem or specific. In the EU, tariff rates outside of quota average 45 percent ad valorem equivalents, with rates on barley, sugar, and red meat in excess of 100 percent. In the United States, tariff rates within quota are relatively low at an average 0f 9 percent ad valorem equivalent, but tariff rates outside of quota can run as high as 150 percent for groundnuts and more than 100 percent for sugar.

A reduction in domestic price supports for agriculture in the EU and the United States would affect Egypt in two ways. It would raise the price of Egypt's cotton exports, but it would also increase the cost of its food imports. This issue is unlikely to be resolved until the Doha Round resumes.

Developing countries face other problems with respect to trade with the industrial countries in food and other agricultural products. These include competition from subsidized export

credit and unfair application of sanitary and phytosanitary trade restrictions to restrict imports.

Details regarding the EU and U.S. tariff rate structures, including the application of free trade and other preferential agreements, are available on the Internet at the following addresses:

- EU— http://www.eurunion.org/legislat/customs.htm#TARIFFSCHEDULE
- United States—http://dataweb.usitc.gov/scripts/tariff.asp

Economic Impacts of Trade Agreements

This subsection focuses on the economic impact of several trade agreements entered into by the United States and by the EU over the past 15 years. It does *not* examine unilateral trade reforms undertaken to meet commitments to international financial institutions (e.g., structural and sectoral adjustment reforms undertaken as part of agreements negotiated with the International Monetary Fund or the World Bank) nor the effect of Uruguay Round commitments negotiated under the auspices of the WTO. Economic lessons from trade agreements elsewhere should help to guide Egyptian policymakers as they shape the reaction of Egypt to ongoing and future FTAs.

Trade agreements are negotiated for a variety of reasons. The most common is to facilitate commercial trade of goods and services via decreases in trade tariffs and nontariff barriers, which protect markets from external competition. This can be done on a multilateral, regional, or bilateral basis. Multilateral agreements at the global level are negotiated through the WTO.

Regional FTAs seek to integrate commercial partners who already do a substantial share of business with each other by offering preferences in order to enhance mutual market access. They may be either multilateral or bilateral depending on how many nations are involved in the agreement. Non-reciprocal preferential trade agreements (PTAs) seek to increase access by developing countries to developed country markets. These agreements do not conform to the principle of non-discrimination that is the hallmark of the world trading system. Under special conditions, however, the system does allow for deviations from that principle. These include both "regionalism" and "differential and more favorable treatment" accorded among developing countries or between developed and developing countries. Regional FTAs are "notified" to the WTO, while PTAs are subject to a waiver being filed with the WTO.[10]

Regional FTAs are often driven by manufacturers seeking to shift some or all of their production offshore in order to take advantage of lower costs of doing business in emerging

[10] From 1948-1994, 124 regional trade agreements were notified to the WTO's predecessor, the General Agreement on Tariffs and Trade (GATT). Since the WTO was launched in 1995, more than 130 such agreements have been notified. For further information, see "Regional Trade Agreements: Facts and Figures" at www.wto.org.

markets. For Western Europe, this has meant two things: enlargement of its economic union to include southern and central European neighbors and deeper partnership with Mediterranean rim countries that includes progressive trade integration, but not full economic integration. The negotiation of these agreements has usually followed outward processing arrangements pursued by commercial firms with low-cost neighbors to the south and east of the EU. U.S. manufacturers pursue the same outward processing arrangements with partners in lower cost, neighboring countries. In response, its trade negotiators have developed partnership agreements with Caribbean countries and an FTA with Mexico and Central American countries.

FTAs are sometimes negotiated between diplomatic partners more for political than economic reasons. These agreements are symbolic of a deepening relationship between the countries, despite the fact that a relatively insignificant percentage of total trade of the partners is actually exchanged between the them. In these cases, the anticipated benefits may have less to do with trade-related market access than with increased investment flows, military aid, development-related technical assistance, diplomatic support for non-commercial issues, education and cultural exchanges, more facile entry into each other's countries for business and private travel, and the like.

ANTICIPATED ECONOMIC EFFECTS OF TRADE AGREEMENTS

An FTA can have a number of economic effects. These include

- Trade flows,
- Investment flows,
- Sectoral resource reallocation,
- Employment and labor market effects,
- Supply-chain integration and competitiveness, and
- Overall economic growth.

The immediate effect of an FTA is on the tariffs and nontariff barriers that regulate trade of goods and services between partner countries. All else being equal, an FTA leads to a reduction in the prices of goods being imported from partner countries relative to goods being imported from non-partners. This in turn leads to increased demand for the products of partner countries. By changing relative prices between partner countries and countries that are not partners, an FTA potentially affects trade flows of goods and services between these various parties.[11]

Such increases or shifts in trade flows may not always be optimal from an economic point of view. An FTA may simply "divert" trade from a low-cost to a high-cost producer rather

[11] While trade agreement analyses have typically focused on trade in goods, the value of global trade in services – e.g., advertising, communications, education, financial, information technology, legal, medical, tourism, transportation, etc. – has grown to account for about one-fifth of all world trade (WTO 2003). It therefore occupies an increasing share of trade negotiators' attention (Zoellick 2003). See the website of the Coalition of Service Industries, which has taken an active lobbying role in support of service-related aspects of US free trade agreement negotiations (www.uscsi.org).

than "create" new trade flows. Trade *creation* is the expansion of exports and imports among trading partners as the lowering of tariffs and elimination of nontariff barriers create new opportunities for trade. Trade *diversion* occurs when tariff reductions result in increased trade between high-cost trade partners at the expense of pre-existing trade with low-cost countries outside the partnership.

A second effect of an FTA is on the flows of capital that may be induced. Increased investment flows may ensue between partner countries because of the increased confidence engendered by the agreement. Increased investment may also result from countries that are not party to the trade agreement, but whose nationals are interested in establishing a commercial foothold in one of the partner countries in order to take advantage of preferential market access in another partner.

Private investment flows may affect the structure of local ownership, which can in turn influence the responsiveness of firms to local economic, social, or political conditions. Foreign capital inflows can be made in the form of FDI, portfolio investment, and commercial bank lending. With FDI, ownership, and perhaps control, of companies is transferred wholly or partially to foreign hands. With portfolio investment, on the other hand, some percentage of holders of bonds and equity stocks may be foreigners, but it is less likely that control will pass into their hands. With commercial bank lending, control remains with the original owners unless they go into default.

Third, with changes in trade and investment flows in response to changes in levels of protection, resources are shifted across sectors of the economy. Land, labor, capital, and even water are reallocated from the production of goods and services in which a country is less competitive to the production of goods and services in which it enjoys new opportunities. These shifts are not instantaneous because investments are required and individuals and firms may not immediately see the new opportunities. Such shifts are also not without social costs, for there are always both winners and losers of such transitions. Forecasting the political economy of these impacts by region, sector, skill group, income group, and demographic group helps a country prepare for an FTA. It allows policymakers to identify who will be in favor of change, who may need new skills in order to respond to new opportunities, and who will need social "safety nets" to aid them during the transition.

The costs and benefits of employment creation and destruction, as resources are reallocated, may be felt separately in different sectors. Jobs will be created in new sectors that have a competitive advantage and will be lost in sectors that are not competitive. FTAs may also affect work conditions. For instance, U.S. FTAs usually include chapters addressing international labor standards and local labor laws. Once a country has a signed a trade agreement with the United States, U.S. companies become increasingly sensitized to the need to monitor working conditions in the plants of their foreign partner firms.

An important positive spillover of FTAs can be an increase in supply-chain integration. Local firms become more likely commercial partners—as subcontractors, suppliers, joint venture partners, and possible merger or acquisition targets—of foreign firms. These may

be from the trade partner country or from other countries. Foreign firms seeking to take advantage of duty preferences under an FTA, for example, might establish linkages with a manufacturing base in Egypt even before an FTA is concluded. Such increased integration may bring a host of new benefits, including foreign investment, market linkages to overseas consumers, access to improved management practices, and transfer of technology.

The ultimate objectives of most countries pursuing trade agreements are enhanced economic growth, growing employment, and increased prosperity for a greater share of their citizens. On the production side, the dynamic benefits of trade liberalization that foster growth include access to lower cost raw materials and intermediated products, increased investment, and learning effects associated with exposure to internationally competitive technologies and management practices. Consumers benefit from lower prices and improved access to higher quality goods and services.

DEVELOPING COUNTRY TRADE AGREEMENTS WITH THE UNITED STATES AND THE EUROPEAN UNION

Until 2000, the United States had negotiated FTAs with a limited number of trade partners. In 1985, it signed its first bilateral FTA with Israel. The scope of this agreement was expanded in 1986 to include preferential treatment for goods exported from in the West Bank and Gaza Strip and from qualifying industrial zones (QIZ) in Jordan. The 1989 United States-Canada Free Trade Agreement was superceded in 1994 by the partnership of Canada, Mexico, and the United States in the North America Free Trade Agreement (NAFTA). In 2001, the United States and the Kingdom of Jordan concluded an FTA.[12]

Under the Bush administration, the pace of FTA negotiations has picked up considerably. To some extent, such agreements provide a more practical alternative to multilateral trade negotiations, for it takes much longer to achieve consensus among all member countries. Success in regional negotiations can then build leverage and momentum to tackle issues multilaterally. In addition to the three FTAs (Israel, NAFTA, and Jordan), the United States signed an FTA in 2003 with Singapore, Chile, and five Central American countries (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua). An agreement with Australia was finalized in February 2004.

The United States is pursuing FTAs with Bahrain, as part of a broader proposed Middle East Free Trade Agreement; the Dominican Republic; Morocco, and members of SACU—Botswana, Lesotho, Namibia, South Africa, and Swaziland. The United States has also proposed the "Free Trade Area of the Americas," a broad FTA to encompass all countries in the Western Hemisphere.

In addition to these FTAs and to the U.S. Generalized System of Preferences with developing countries, are several PTAs between the United States and developing

[12] For perspective on the dynamics and strategies of international economic negotiations from a US perspective, see Odell (2000).

countries. The 2000 U.S. Trade and Development Act addressed preferential trade between the United States and partners in sub-Saharan Africa and the Caribbean. The United States also offers duty preferences for exports from four Andean countries. PTAs are of limited duration, and must be renewed periodically by the U.S. government.

Sometimes the economic effect of formal trade relations comes about simply from "normalization" of trade relations, rather than the conclusion of FTAs. This is the case of U.S. trade relations with China, normalized in 2000, and with Vietnam, which signed a bilateral trade agreement with the United States in 2000 but has not yet been accorded normal trade relations status, pending approval by the U.S. Congress.

The EU, Egypt's largest trading partner, has or negotiating association agreements with its Mediterranean and other bilateral partners. The EU sees its relations with twelve Mediterranean partners[13] as part of a regional cooperation program, forged through the Barcelona Declaration of 1995. Egypt's Cooperation Agreement with the EU dates from 1978. A more comprehensive association agreement, signed in 2001, was ratified by the Egyptian and European Parliaments and is expected to be ratified by all member state governments by the end of 2004. The EU also negotiated bilateral FTAs with key trade partners such as South Africa[14] and Mexico in 2000. The EU's trade relations with enlargement candidates in Central Europe are not considered here.

North America Free Trade Agreement

NAFTA was negotiated between the United States and its two largest bilateral trade partners, one of which is a significant developing country economy. Mexico's labor-intensive manufacturing-for-export sector, known as the *maquiladora* industry, predates the FTA by almost 30 years. *Maquiladora*s are bonded export firms, developed for the assembly, packaging, processing, or transformation of goods for export in any industry. The original *maquiladora* legislation allowed FDI in export processing zones located within 20 kilometers of the U.S.-Mexico border (Warden 2000). From the beginning, manufacturing components were imported duty-free into Mexico, with final goods re-exported to the United States. Import duties in the United States were only charged on the local value-added created in Mexico.

With implementation of NAFTA in 1994, economic integration intensified between the two countries. A multiyear reduction or elimination of import tariffs was begun. After ten years of phasing in tariff reductions under NAFTA, most of Mexico's exports to the United States

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[13] From west to east, they are Morocco, Algeria, Malta, Tunisia, Egypt, Jordan, the Palestinian Authority, Israel, Lebanon, Syria, Cyprus, and Turkey.

[14] According to the EU, ratification of the TDCA between the EU and South Africa is still ongoing. Its trade-related articles, aimed at implementing a free trade area over 12 years, have been provisionally applied since January 2000. See http://europa.eu.int/comm/trade/issues/bilateral/countries/southafrica/index_en.htm.

no longer depend on Mexico's *maquiladora* program for duty preferences in the U.S. market. Most remaining tariffs will be eliminated by 2008.[15]

United States-Israel and United States-Jordan FTAs

While the negotiation of an FTA between Mexico and the United States was driven primarily by economic concerns and yet had political implications,[16] the pursuit of FTAs with two key Middle East allies—Israel and Jordan—was driven by diplomatic concerns but has had important economic consequences for Israel and Jordan. The shares of imports of these countries in U.S. trade have increased substantially, albeit from a much lower base. In 2002 Israel and Jordan supplied 1 percent and 0.04 percent of U.S. imports, respectively. By way of comparison, U.S. imports of goods from Egypt represented 0.12 percent of total imports in 2002.

U.S. FTAs currently under negotiation with Morocco and Bahrain are driven by similar motives. Their attraction for these countries is the possibility of increased investment flows, as experienced by Israel and Jordan, that will help to create sorely needed employment.

Jordan's QIZ arrangement preceded the U.S. FTA by 15 years. Investment flows into Jordan were therefore already encouraged from the United States, as well as from other countries, before the FTA took effect. Pakistani, Taiwanese, and other Asian sources of capital were particularly important in financing the surge in textile-related activity. Moreover, cumulation with Israeli inputs is allowed for rules of origin under the trade agreements with the United States, giving added preference to exports from both countries.

Preferential Trade Agreements

Since 1984, the United States has offered preferential duty treatment on clothing exports from 24 Caribbean countries.[17] This clothing must be made of U.S. woven fabrics made of U.S. yarn or, for certain knit garments, Caribbean knit fabrics made of U.S. yarn. In 2000, the Caribbean Basin Trade Preference Act expanded product coverage to provide NAFTA-equivalent treatment for Caribbean exports of footwear, canned tuna, petroleum products, watches, and watch parts.

The Africa Growth and Opportunity Act (AGOA) with the United States grants 34 sub-Saharan countries[18] preferential market access for a wide range of exports. With respect to

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[15] This chapter focuses largely on the economic impact of NAFTA on Mexico because of the relative importance of NAFTA and the abundance of secondary literature on Mexico. From the U.S. perspective, Mexican imports have grown from 6.6 percent to 11.6 percent under NAFTA, while U.S. exports to Mexico have grown from 9 percent to 14 percent. From Mexico's perspective, exports to the US represent 89 percent of total exports, while imports from the United States are 63 percent of total imports.

[16] It also was pursued by the Mexican government as a way of solidifying its pursuit of liberalized policies, which in turn had domestic political consequences.

[17] Antigua and Barbuda, Aruba, Bahamas, Barbados, Belize, Costa Rica, Dominica, Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Montserrat, Netherlands Antilles, Nicaragua, Panama, St. Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Trinidad and Tobago, and British Virgin Islands.

[18] Benin, Botswana, Cape Verde, Cameroon, Central African Republic, Chad, Republic of Congo, Djibouti, Eritrea, Ethiopia, Gabon, Ghana, Guinea, Guinea-Bissau, Kenya, Lesotho, Madagascar, Malawi, Mali,

textiles and apparel, quota-free, duty-free access is provided to the U.S. market, subject to country-of-origin restrictions. These origin requirements were suspended for 28 of the lesser developed beneficiary countries, allowing them to use fabrics imported from third countries for garment manufacture until September 2004.[19]

The United States also offers trade preferences to Bolivia, Colombia, Ecuador, and Peru through the Andean Trade Preference Act, which was signed in 1991 and amended in 2002. Both of these acts expand the product coverage of the U.S. Generalized System of Preferences, offer more generous duty reduction provisions for beneficiary countries, especially with respect to labor-intensive manufactures such as textiles and apparel and footwear, and eliminate GSP competitive-need limitations (i.e., quotas on GSP benefits).[20]

IMPACTS OF EGYPT'S TRADE AGREEMENTS

There is little analysis of the economic impacts of Egypt's existing trade agreements and most analysis of has been anticipatory.[21] In part, this is because most agreements have not had a long implementation period. Some, including the Agadir Free Trade Agreement linking Egypt with Jordan, Morocco, and Tunisia just signed in February 2004, have been strongly supported by the EU as a regional complement to its bilateral association agreements with individual Mediterranean rim countries.[22]

Egypt's trade balances are in deficit with all trading partners. Its largest partner is the EU, with which it has had a cooperation agreement since the mid-1970s. Imports from the EU to Egypt climbed in the late 1990s, from $3.5 billion to $6 billion, according to UN Comtrade statistics, but have slowed recently, while the value of exports has held steady at about $1.4 billion (see Figure 3-1). The effect of the EU Association Agreement with Egypt is likely to be small, because Egypt's tariff decreases on most final industrial products will take place over a period of 12 years and those on a few products, such as automobiles, will be stretched out over 15 years. Egypt's industrial goods already enter the EU duty-free. The association agreement has made a few concessions on agricultural products, which are largely subject to tariff rate quotas in Europe. The issue of market access for Egypt's agricultural exports will be taken up again in 2005.

Mauritania, Mauritius, Mozambique, Namibia, Niger, Nigeria Rwanda, São Tomé and Principe, Senegal, Seychelles, Sierra Leone (delayed implementation for Sierra Leone), South Africa, Tanzania, Uganda, and Zambia.

[19] Extension of the third-country sourcing waiver is being debated in the U.S. Senate.

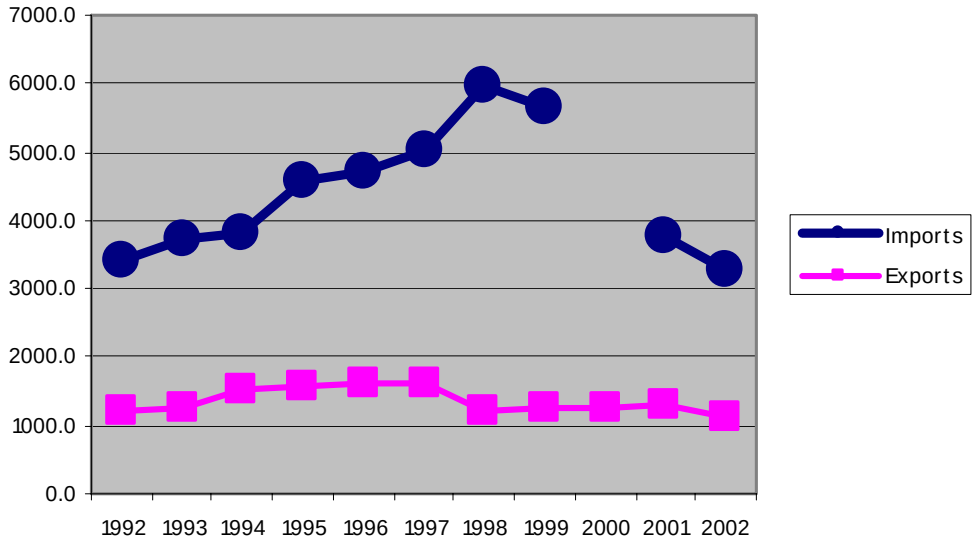
[20] "Competitive-need limitations … impose ceilings on GSP benefits for each product and country. A country will automatically lose its GSP eligibility for a product (which is defined by its eight-digit Harmonized Tariff System tariff category) if the [competitive-need limitations] are exceeded. A beneficiary country loses GSP eligibility for a product if, during the previous calendar year, U.S. imports of a GSP article from that country (1) account for 50 percent or more of the value of total U.S. imports of that product, or (2) exceed a certain dollar value." See USTR, Generalized System of Preferences, Part I: Most Frequently Asked Questions, http://www.ustr.gov/reports/gsp/faq.html.

[21] The Egyptian Center for Economic Studies (www.eces.org.eg) is a good source of such analyses.

[22] For an assessment of the coherence of the increasing number of bilateral and regional FTAs in the Mediterranean region with one another and with the overarching multilateral framework of the WTO, see Zarrouk and Zallio (2000).

Egypt, which joined the African free trade group COMESA in 1998, has yet to see significant benefits accrue. In 2002, Egypt's exports to COMESA represented just 2.8 percent of all exports and 0.6 percent of all imports (TradeMap). Egypt's overall trade balance with COMESA, however, is positive. Primary products exported include fuel and other chemical products including plastics, iron and steel products, cereals, and paper products. Primary imports are coffee, tea, and spices; oilseeds; and cotton. In 2001 the in Egypt reported that COMESA officials were unhappy with the slow pace of Egypt's tariff reductions, customs reform, and trade integration (American Chamber of Commerce in Egypt 2001).[23]

Figure 3-1
Egypt-EU Trade Values, 1992–2002



SOURCE: *United Nations Comtrade database*

Hoekman and Messerlin (2002) warn that Arab regional trade integration agreements that look only at merchandise trade (such as GAFTA), without also considering trade in services, investment, and factor flows or institutional and regulatory issues, will fail to provide meaningful benefits for Mediterranean rim countries. Their markets are generally too small and their economies are too similar.[24] Liberalization in these complementary sectors is essential for improving competitiveness and broadening employment creation opportunities in service-sector related fields (Hoekman and Messerlin 2002).

An analysis undertaken by the Egyptian Center for Economic Studies of the anticipated effects of an Egypt-Turkey FTA, which is still under negotiation, suggests that the structure of the draft agreement would not produce sufficient economic benefits for Egypt (Kheir-El-

[23] http://www.amcham.org.eg/publications/BusinessMonthly/September%2001/reports(comesa).asp
[24] Low degree of economic complementarity is also cited as a constraining factor by Samiha Fawzy (2002).

Din, Fawzy, and El-Khawaga 1999) [25]. In terms of direct effects, the greater competitiveness and diversification of Turkey's economy would allow it to take advantage of opportunities in Egypt to a greater extent than Egyptian exporters and investors would be able to take advantage of opportunities in Turkey. Moreover, because Egypt's economy is more protected than Turkey's, Egypt would be subject to greater import threat and greater trade diversion than Turkey following the establishment of an FTA. The ECES study pointed out that Egypt's abundance of lower-cost labor, combined with its gateway status to COMESA and Arab markets, should make it a more attractive FDI recipient than Turkey.

OBSERVED ECONOMIC IMPACTS OF TRADE AGREEMENTS

Trade Flows

MEXICO

Official Mexican trade statistics distinguish between *maquiladora* exports and non-*maquiladora* exports. Exports of *maquiladora* products have grown from 35–40 percent of total exports just before NAFTA (Gruben 2001) to nearly 50 percent now (Instituto Nacional de Estadística Geográfica y Informática [INEGI] 2004).

Mexico's most important export categories to the United States, at the two-digit level, are sophisticated manufactures such as electric machinery (especially cables and television sets), automobiles and components, computers and parts, and instruments (optical, photographic, and medical), as well petroleum, garments, and fresh vegetables (Table 3-5).

For categories shipping at least $500 million in 2002, the 10 fastest growing categories of imports into the United States from Mexico between 1998 and 2002 are:

- Articles for arcade, table, or parlor games (221 percent)
- Electric apparatuses for telephone lines (208 percent)
- Tractors (180 percent)
- Medical, surgical dental, veterinary instruments (159 percent)
- Refined oil (157 percent)
- Crude oil (131 percent)
- Refrigerators, freezers, heat pumps (128 percent)
- Transistor apparatuses for radio, telephone, television, camera (108 percent)
- Electric switching boards (100 percent)
- Computers, office machines (97 percent)

On the export side, from the United States to Mexico, the most important categories of goods shipped mirror some of those sent from Mexico to the United States, but also include several more specialized input categories as seen in Table 3-6.

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[25] Hanaa Kheir-El-Din, Samiha Fawzy, and Laïla El-Khawaga, "The Egyptian-Turkish Free Trade Area Agreement: What are the Expected Benefits?" Egyptian Center for Economic Studies Working Paper no. 39 (Cairo: ECES, December).

Table 3-5
Top 10 U.S. Imports from Mexico, 2002 (US$ million)

Imports (by 2-digit HS code)	Value	Top 2 categories (by 4-digit HS code)	Value
85 Electric machinery	32,660.7	8544 Insulated wire, cables 8528 Televisions, video monitors	5,590.0 4,845.5
87 Vehicles	26,355.3	8703 Vehicles (transporting persons) 8704 Vehicles (transporting goods)	13,529.9 6,703.6
84 Machinery	17,731.6	8471 Computers, office machines 8473 Parts for computers, office machines	7,138.2 1,513.1
27 Mineral fuel	12,229.7	2709 Crude oil 2710 Refined oil	11,515.9 658.3
90 Optic/photo/medical instruments	5,344.9	9032 Automatic regulating instruments 9018 Medical, surgical, dental, veterinary instruments	1,557.6 1,505.8
94 Furniture, bedding	4,543.8	9401 Seats and parts 9405 Lamps, lighting fittings	3,099.2 710.3
62 Apparel, woven	4,504.2	6203 Men's/boys' suits, ensembles 6204 Women's/girls' suits, ensembles	1,944.5 1,585.4
98 Special classifications	4,192.5		
61 Apparel, knit	3,135.0	6109 T-shirts, tank tops 6110 Sweaters, pullovers	922.5 801.8
07 Vegetables	1,799.0	0709 Misc. vegetables, fresh or chilled 0702 Tomatoes, fresh or chilled	635.6 551.8

SOURCE: USA Trade Online, Department of Commerce

Table 3-6
Top 11 U.S. Exports to Mexico, 2002(million $)

Exports (by 2-digit HS code)	Value	Top 2 categories (by 4-digit HS code)	Value
85 Electric machinery	21,899.2	8542 Electronic integrated circuits 8540 Cathode tubes	4,084.7 1,868.8
84 Machinery	14,853.6	8471 Computers, office machines 8473 Parts for computers, office machines	2,721.9 2,595.3
87 Vehicles	10,690.4	8708 Motor vehicle parts & accessories 8703 Vehicles (transporting persons)	6,465.3 3,148.2
39 Plastics and plastic articles	6,684.4	3926 Miscellaneous plastic articles 3923 Plastic containers	1,709.7 1,125.8
98 Special classifications	3,721.7		
90 Optic, photo, medical instruments	3,438.1	9018 Medical, surgical, dental, veterinary instruments 9032 Automatic regulating instruments	731.1 527.8
27 Mineral fuel	3,268.4	2710 Refined oil 2711 Petroleum gasses	2,206.1 806.7
48 Paper and paperboard products	2,080.6	4819 Paper cartons 4804 Kraft paper and paperboard	697.4 224.1
29 Organic chemicals	1,929.7	2902 Cyclic hydrocarbons 2909 Ethers, etc.	606.7 166.3
73 Iron or steel articles	1,750.2	7326 Miscellaneous iron or steel articles 7318 Screws, nuts, bolts	871.3 318.9
10 Cereals	1,608.5	1005 Corn 1007 Grain sorghum	663.8 452.4

SOURCE: USA Trade Online, Department of Commerce

Mexico is an important importer of U.S. feed grains. It is the United States' second-largest importer of corn (more than 5 million metric tons in 2002/03) and largest importer of sorghum (3-4.6 million metric tons in 2001/02 and 2002/03). NAFTA has also encouraged U.S. soybean exports to Mexico, where domestic crushing of imported oilseeds provides oilseed cake ingredients to the domestic animal feed industry. The growth in field crop imports has raised concerns about employment and income loss by small farmers in the rural sector, who are unable to compete with the United States' capital-intensive agricultural exports (Weinberg 2004).

For categories shipping at least $500 million in 2002, the 10 fastest growing categories of imports into Mexico from the United States between 1998 and 2002 are

- Petroleum gases (337 percent),
- Television, radio, radar apparatus parts (219 percent),
- Cyclic hydrocarbons (163 percent),
- Internal combustion engines (153 percent),
- Motor vehicles for transporting persons (125 percent),
- Computers, office machines (93 percent),
- Plastic containers (91 percent),
- Medical, surgical dental, veterinary instruments (83 percent),
- Beef, fresh or chilled (77 percent),, and
- Parts for computers, office machines (74 percent).

Increasing dependence on one trading partner has meant that Mexico's economy is intertwined even more closely with the U.S. economy. Whereas 69 percent of Mexico's total exports went to the United States in 1990 before NAFTA, by 2003 Mexico sent nearly 90 percent of its exports to its neighbor to the north (INEGI 2004). Castro (2003) highlights the high degree of interrelationship between the U.S. and Mexican economies, suggesting that 78 percent of imported inputs into the *maquiladora* industry come from the United States and that 85 of the top 100 employers are either American or Japanese.

The downside of such economic integration is that the downturn in the U.S. economy has also caused Mexico's economy to suffer. Mexico has also had to contend with rising competitive pressures from other parts of the world. Audley et al. (2003) suggest that nearly one-third of jobs created in the *maquiladora* sector in the 1990s have shifted to lower-wage, higher-productivity countries, especially in Asia. Some are input industry jobs that have moved offshore, though final product assembly is still carried out in Mexico. In other instances, Mexico has lost final product market share in the United States to foreign competitors, most notably China. In textile and garment exports, for example, NAFTA helped Mexico to become the leading supplier of garments to the United States by 1997. However in 2002 China reclaimed its position over Mexico as the largest single-country supplier (Table 3-7).

Table 3-7
Major Shippers' Market Shares of Textiles and Garments to United States (%)

Shipper	1983	1995	1997	2003
ASEAN	7.4	14.0	12.6	15.6
China	8.1	10.2	10.5	15.2
Caribbean	2.0	15.7	17.7	12.6
Mexico	1.8	7.4	11.8	10.5
CAFTA	(included under Caribbean)			9.2
EU15	n/a	n/a	n/a	5.6
Hong Kong	23.2	12.1	9.2	5.1
India	2.4	3.	3.1	4.2
Canada	n/a	n/a	n/a	4.1
Korea	17.1	4.7	3.5	3.4
Taiwan	18.5	5.9	4.8	2.9
Bangladesh	n/a	3.1	3.4	2.6
SS Africa	n/a	n/a	n/a	2.0

NOTE: Figures for 2003 are through 11/03.

SOURCES: 1983 – Cline (1987); 1995, 1997 – American Apparel & Footwear Association; 2003 – Department of Commerce, Office of Textiles and Apparel, "Major Shippers Report"

Another indirect, negative effect of NAFTA was on the competitiveness of exports from neighboring countries in the Caribbean. NAFTA improved and broadened the tariff treatment of Mexico's exports to the United States which had the unintended consequences of negatively affecting the relative competitiveness of Caribbean garment exports, diverting trade in favor of Mexico. This issue was addressed in 2000 when the Caribbean Basin Trade Partnership Act put garment exports on a more equal footing with those from Mexico.

JORDAN

The United States–Jordan FTA phases tariff liberalization in over 10 years. Working with trade data through 1999, two studies anticipated the economic effects of the United States–Jordan FTA (U.S. International Trade Commission 2000; Lord and Uraidi-Hammudeh 2001). The U.S. International Trade Commission concluded that an FTA would not be expected to have a measurable impact on U.S. imports from Jordan for 15 of the 16 sectors they examined, but that for the remaining sector—textiles and apparel— imports would probably rise. Its effect would nevertheless be negligible on total U.S. imports, production, and employment. USITC also noted that the United States–Jordan FTA was not expected to have a measurable impact on U.S. exports for the sectors selected for review. Lord and Uraidi-Hammudeh found that the FTA would open many opportunities for Jordan to expand exports to the U.S. market, particularly for "emerging export products" such as Dead Sea cosmetics, orthopedic appliances, rugs, and machinery, as well as for more standardized products such as apparel and clothing, aluminum, animal feed, and insecticides.

The three additional years of trade data now available from the U.S. Department of Commerce indicate that U.S. exports to Jordan have grown since the United States–Jordan FTA went into effect. Exports from Jordan to the United States, however, have climbed dramatically, from just $29 million in 1995 to more than $400 million in 2002 (Table 3-8). Nevertheless, this still represents just 0.04 percent of all U.S. imports.

Table 3-8
United States–Jordan Trade Flows (US$ thousand)

HS code	Item	1995	2000	2001	2002
U.S. EXPORTS					
TOTAL		335,285	316,696	338,980	404,438
10	Cereals	135,468	70,946	91,026	53,168
84	Machinery	30,532	44,482	39,049	45,293
88	Aircraft and parts	21,262	19,616	27,149	43,256
85	Electrical machinery, parts	17,319	23,551	24,202	38,668
93	Arms and ammunition	3,871	9,841	5,543	32,107
90	Optical equipment	8,005	15,803	17,456	30,293
87	Vehicles	18,668	8,476	7,945	17,220
98	Spec. classification provisions	14,400	9,863	13,354	16,617
15	Edible oils	9,242	8,071	10,685	15,830
24	Tobacco	1,761	17,218	18,356	10,780
	All other	74,758	88,829	84,219	101,206
U.S. IMPORTS					
Total		28,807	73,259	229,084	412,334
61	Apparel, knitted or crocheted	5,747	16,636	119,113	275,205
62	Apparel, not knitted or crocheted	9,263	26,078	64,723	109,068
71	Jewelry	2,726	9,388	8,942	11,626
98	Spec. classification provisions	4,954	4,034	6,645	2,547
25	Salt, sulfur, earth, and stone	-	17	2,026	1,746
84	Machinery	502	488	3,080	1,500
29	Organic chemicals	-	222	113	1,320
39	Plastics and plastic articles	351	425	613	904
97	Antiques	11	1,787	1,237	732
42	Leather products	12	8,717	15,492	729
	All other	5,242	5,468	7,100	6,957

SOURCE: USA Trade Online, U.S. Department of Commerce

The value of Jordan's garment exports to the United States has expanded nearly nine-fold since just before the FTA was implemented and now makes up 93 percent of total export value, compared with between 7 and 21 percent in the years immediately preceding the

signing of the FTA. It remains to be seen what the effect of the phasing out in 2005 of the WTO Agreement on Textiles and Clothing will have on a small exporter like Jordan.

According to TradeMap, the United States absorbed 20 percent of Jordan's total exports in 2002. However, 38 percent of Jordan's knit garments exports and 89 percent of its woven garments exports went to the United States that same year.

MOROCCO

An FTA between Morocco and the United States was signed in early March 2004.[26] Morocco's total trade with the United States represents less than 0.5 percent of U.S. trade and almost 4 percent of Moroccan trade.

Starting from this small base, the issues that Morocco faces have to do with possible post-FTA scenarios. Morocco is becoming a hub for labor-intensive manufacturing for export. Many European companies and a few American and Japanese firms have established manufacturing bases in Morocco, especially near the port cities of Tangiers and Casablanca. Morocco's clothing assembly industry has been active for a long time under bonded warehouse arrangements, but industrial-component exports for the chemical, electrical, and automobile industries are growing in importance.

The sticking point in. negotiations for this agreement was with respect to agricultural trade (Belghazi, Plunkett, and Salinger 2002). The United States is a competitive supplier of cereals, feed grains, and livestock products. Yet these same products represent an important share of Morocco's agricultural GDP and an important part of the livelihood of Morocco's rural poor. In the reverse direction, Morocco is a competitive supplier of fresh vegetables, citrus, and other fruits, particularly in the "edge" seasons before and after European and American produce hits local markets. Yet these same products are important for key horticultural producers in the United States, such as California and Florida, and key exports from Mexico to the United States.

Complementary products and services might phase in tariff reduction. For instance, it might be feasible to liberalize trade in feed grains and oilseeds in advance of bread wheat, durum wheat, barley, and meat products. This would provide some agricultural export opportunities for the United States while at the same time give Morocco longer to increase the competitiveness of Moroccan food grain producers or encourage their transition to alternative opportunities. This would also provide feed inputs into Morocco's poultry and red meat sectors at lower cost, allowing them to increase their competitiveness before the arrival at lower tariffs of U.S. chicken and beef.

In addition to trade in goods, the United States–Morocco trade relationship will increasingly incorporate trade in services. Morocco's tourism, transportation, banking, communications, energy, and financial sectors all offer interesting trade opportunities. Like

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[26] This analysis was undertaken before the signing and may not anticipate all elements of the agreement.

in other comprehensive FTAs that the United States has negotiated in recent years, services trade is important in the United States–Morocco FTA.

b. Investment Flows

MEXICO

Mexico's experience with international capital flows before NAFTA demonstrated the risks associated with opening up the financial sector. As American investors took interest in their neighbor to the south, before NAFTA, capital flows into Mexico—both portfolio investment and FDI—increased substantially. During political instability in Mexico in 1994, just before NAFTA went into effect, foreign capital quickly pulled out of the country. Rather than being able to hold on to a pegged exchange rate with the U.S. dollar, private markets attacked the Mexican peso, leading to a 50 percent devaluation.

Most of these capital flows were of portfolio capital. FDI was more stable. Furthermore, after the great capital volatility of 1994/95, significant FDI returned to Mexico. Vollrath (2003, 14) reports that "post-NAFTA expansion of intra-member FDI has tripled in value." The food processing sector has witnessed both a doubling of FDI in Mexico and an increase in the export of processed foods to Mexico.

JORDAN

The notable effect of the United States–Jordan FTA—and the QIZ arrangement that preceded it—on investment flows is the amount of Asian capital it has attracted from textile/clothing firms seeking a new export platform from which to do business and thereby avoid quota restraints. Israeli and Turkish capital has also been invested in Jordan.

MOROCCO

Belghazi, Plunkett, and Salinger (2002) observed that the U.S. FTA with Morocco may offer more interesting opportunities for investment flows than for trade in goods and services. Because Morocco is also party to an association agreement with the European Union, its goods—both agricultural and industrial—receive preferential access in Europe.[27] This makes Morocco, with its ease of truck freight passage by ferry across the Straits of Gibraltar to Algeciras in Spain, a desirable off-shore manufacturing center for export into Europe. Morocco has already seen an increase in FDI for everything from microchips to electricity generation as foreign investors from around the globe seek to take advantage of the economic activity to be generated by its upcoming dual FTA opportunities.

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[27] Negotiation of the Association Agreement's agricultural chapters was concluded in October 2003, but still awaits ratification. See "Le détail de l'accord agricole avec l'UE," October 30, 2003 archives, www.leconomiste.com.

c. Employment, Wages, and Labor Conditions in Mexico

From just more than 500 operations in 1980, the *maquiladora* sector grew to almost 3,750 operations in 2000 found in every state of the country. Direct employment in *maquiladoras* rose from 100,000 jobs in 1980 to 1.3 million jobs in 2000, with a slight downturn in 2001 and 2002. Despite greater regulatory flexibility with respect to the location of *maquiladora* plants, 84 percent of employment and 81 percent of plants are still located in the six states that border the United States (Castro 2003). Employment has dropped sharply outside the *maquiladora* industry since 2000 (INEGI, reported in Audley et al. 2003). However, it is hard to distinguish between NAFTA-induced employment effects and the impact of the peso crash in 1994 on exports and thus employment.

Audley et al. (2003) point to the fact that this gain in manufacturing jobs barely compensates for the number of jobs lost in the agricultural sector due to increased imports from the United States. Mexico's agricultural sector has had a hard time competing with U.S. productivity and agricultural support levels. U.S. exports of cereals, feed grains, livestock products, and processed foods compete successfully against Mexican products. Those hit hardest by these imports on the Mexican side are the poorest farm households with the lowest productivity.

Remuneration is higher among exporting firms in Mexico. "Average salaries in companies exporting most of their production are 30 percent higher than in non-exporting firms, and workers in firms with FDI earn 50 percent more than the national average" (Hufbauer and Schott 2002, 22).

However, Revenga notes that increased trade liberalization in Mexico, begun before NAFTA, has led to increased inequality of wages across the Mexican labor force, as wages are increasingly tied to skill levels (Revenga 1995). This finding is echoed in other studies that also document the wage premium paid for skills as a result of trade liberalization.[28]

Moreover, the competitive pressures felt in some sectors of the Mexican economy, such as traditional field agriculture, have led to declining wages and increased pressure on workers to migrate in search of greater remuneration elsewhere. Mexico is the second-largest recipient in the world of migrant remittances, measured in terms of total value of flows ($9.9 billion in 2001 according to Ratha [2003]). Migrant labor in Mexico is supplied largely by the rural poor, who immigrate to Mexico's urban areas or who seek to cross the border into the United States.

By fostering resource reallocation, trade agreements not only encourage shifts among sectors of an economy but within sectors as well. It takes longer for the benefits to spill over to smaller, less well connected firms—if they do at all. Put more starkly, trade liberalization such as was fostered by the *maquiladora* program and NAFTA in Mexico "has had a devastating impact on traditional producers" (Peters et al. 2002, 224). Trade liberalization,

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[28] The effect of trade liberalization on increased wage inequality has been observed in Brazil (Pavcnik et al. 2002), Indonesia (Agrawal 1995), Mexico (Revenga 1995, López-Acevedo 2003).

imposing competitiveness pressures from the world market, frequently leads to losses for smaller firms that have traditionally focused on the domestic, rather than foreign, markets and are less globally connected. Other firms are at the "bottom" of the value chain, working under subcontract for larger assembly houses, often as home workers or under sweatshop conditions. Opportunities for these firms have diminished as the value chains consolidate operations and pay greater attention to working conditions along the chain. Some of those previously employed under such informal conditions will find employment in the formal textile industry; others will not.

d. Supply-chain Integration, Competitiveness, and Workforce Development

As countries increasingly do business with each other, sharing capital and trading goods and services, supply chains become increasingly interwoven across borders. As supply chains become interwoven, workforce skills are transferred to enable a midlevel skill set to emerge, encompassing technical, business, and logistics managers who are capable of handling a greater proportion of the supply chain.

MEXICO

For example, U.S., Mexican, and Canadian agricultural sectors are becoming increasingly unified. Benefits of this integration include better exploitation of comparative advantage, realization of increasing efficiencies with larger returns to scale and thus lower costs, institutional innovations that favor skilled human capital, and increased use of technology (Vollrath 2003).

With respect to the textiles-garments sector, Gereffi, Martinez, and Bair (2002) highlight the development of what they term "full-package services" in Mexico's denim sector. The U.S. garment business has evolved to the point that United States–based merchandisers design and brand products and then outsource the manufacture of those products to subcontractors (usually foreign). These merchandisers require Mexican suppliers who can produce or source their own textiles, trim, and labels; manage cutting and assembly; finish garments through specialized laundering; and handle distribution of shipments to retail outlets in the United States. By reducing tariffs on bilateral trade of inputs and final goods, rather than the *maquiladora* program's focus on end-products only, NAFTA enabled investments in upstream production activities. As Mexican firms and their workers have gained experience in manufacture, assembly, and supply-chain coordination and quality improvement, they export garments of increasing added value per unit, that is, they become more competitive.

The number of firms that can act as lead, full-package suppliers to the U.S. market is not large. In some instances, diversified Mexican holding companies have invested—sometimes in partnership with U.S. companies—in Mexico's textiles and garment operations. In other instances, U.S. companies have sought to increase their control over the Mexican side of the chain by investing directly in Mexico-based production capabilities. Other companies, such as Levi-Strauss, resist direct investment for a long time in favor of maintaining close,

strategic relationships with key textile suppliers and garment assemblers who invest in cutting edge production facilities on the strength of the volume of business they do with the American merchandiser.

How do such "lead firms" emerge? As Gereffi et al. point out, "These new lead firms create opportunities for Mexican suppliers to go beyond the typical *maquiladora* role, but they create only 'opportunities,' not guarantees of success. The presence of local capital, skills, entrepreneurial drive, and other resources is a necessary but not sufficient condition to strengthen the position of Mexican firms in the apparel commodity chain." (Gereffi, Martinez, and Blair 2002, 221) By this definition, only firms that are connected to global markets and have access to capital can readily take advantage of the FTA.

Yet despite the growing evidence of integration and improving productivity, it is not clear that Mexico has invested adequately in competitiveness enhancement and workforce training. For example, when Mexico's poultry tariffs on U.S. poultry products expired at the end of 2002, Mexican poultry farmers responded that they were not yet ready to compete with U.S. imports. In January 2003, the Mexican and U.S. governments negotiated a stop-gap measure. Mexico placed a 99 percent safeguard tariff on imports of dark chicken meat, agreeing with the U.S. government and poultry producers to reduce the tariff by 20 percent each year until January 2008, in exchange for which a tariff-rate quota on dark meat chicken exports was agreed to for 50,000 tons of imported chicken leg quarters in 2003 and 101,000 tons in 2004.

SUB-SAHARAN AFRICA

The failure of Mexico to meet increased competition in a number of industries has implications for small, poorly connected firms in more distant parts of the world. In sub-Saharan Africa, for instance, despite AGOA, which offers preferential access to the U.S. market for many goods, including a four-year quota-free import window for clothing assembled in Africa, many African textile plants still produce low-quality fabrics for highly protected domestic markets. Africa-based garment companies assemble products for export to the United States by accessing internationally priced and fabrics of the appropriate quality from international markets under AGOA's third-country sourcing waiver. However, representatives of "footloose" foreign clothing companies from Asia and the Gulf present in many parts of Africa, are threatening to pull their operations out of Africa if the third-country provision is withdrawn as scheduled.

African companies seek to attract FDI in the more capital-intensive textile sector, but find great difficulty in convincing international investors to take a chance on Africa. Globally, less than 1 percent of all FDI goes to sub-Saharan Africa, and of that, half goes to just two countries: the oil-exporting nations of Angola and Nigeria.

This puts U.S. policymakers in a conundrum. On the one hand, they want to promote industrialization in Africa, which will be encouraged if the rules of origin specifying African input content are enforced—and if investors respond. On the other hand, because

most of Africa's installed textile industry base is still uncompetitive, allowing the third-country sourcing provision of AGOA to expire in September 2004 will likely cause the collapse of many emerging garment industries among AGOA-eligible countries. This in turn will cause significant employment hardship.

e. Economic Growth

What is the dynamic effect of an FTA on economic growth?

MEXICO

A new World Bank study on the lessons of NAFTA for Latin America and the Caribbean finds that NAFTA "has helped Mexico get closer to the levels of development of its NAFTA partners" (Lederman, Maloney, and Servén 2003, v). Both exports and investment inflows would have been lower without it, access to technology would have been much more restricted, and it has resulted in an upgrading of the Mexican workforce.

SOUTH AFRICA

Using the Global Trade Analysis Project's (GTAP) computable general equilibrium (CGE) modeling framework to evaluate ex-ante the effects of the EU–South Africa FTA and writing before the agreement was negotiated, Masters, Davies, and Hertel (1999) pointed out that the extent of South Africa's benefit from trade integration agreements depends on whether agriculture is included or not in the scope of the agreement.[29] The most important gains were to be realized only if agriculture, accounting for 11 percent of South Africa's exports to the European Union in 2002, were included in the agreement. Their analysis also suggested that the FTA risked diverting a portion of South Africa's trade from other trading partners, rather than creating new opportunities, which would result in a net social welfare loss to South Africa. Partly as a result of this study, agriculture was included in the final agreement.

Andriamananjara and Hillberry (2001) also used the GTAP CGE model to find that the static impact on South African growth (0.08 percent of GDP) is greatly exceeded by the total effect inclusive of dynamic benefits (1.42 percent of GDP). Yet the overall "kick" of the FTA is small, mostly because of the long period over which the FTA is phased in and because South Africa's trade with the European Union represents only 40 percent of its total trade.

Tyler (2004) points out that although CGE models used to measure the impact of FTAs on economic growth have evolved in their ambition and scope, they nevertheless find the magnitude of these effects on GDP ranging from less than 1 percent to 4–5 percent of GDP.

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[29] Because regional trade agreements notified to the WTO must cover a "substantial part" of the trade between the two parties, agricultural trade ultimately had to figure in the EU-South Africa FTA.

4. Impact of Trade Regime Changes on Subsectors

Purpose of Subsector Analysis

One approach to analyzing the impact of trade and policy reforms associated with the implementation of FTAs is to undertake detailed sector assessments to understand the microeconomic implications of these agreements and how these affect individual firms. The microeconomic analysis uses a combination of descriptive analysis, cost or profitability analysis, and sectoral competitiveness analysis to begin to quantify the factors on which the success of an FTA may hinge (Abbott, Abdelkhalek, and Salinger 2000). Such an approach requires the following kinds of information:

- Recent trends in production, employment, and trade
- Export performance in relation to world market trends, geographical patterns of trade
- Tariffs and nontariff barriers of Egypt's trade partners and how these might change under various agreements
- Tariffs and nontariff barriers on the Egyptian side, and how these might change under various trade agreements
- What factors influence the potential for Egypt to respond positively to changes in the trade regime
- What constraints inhibit Egypt's ability to respond positively:
    - Tradition of high protection against imports and lack of attention to competitiveness
    - Public ownership of enterprises, poor management, and obligation to pursue social objectives such as employment rather than efficiency
    - Slow, cumbersome, and costly customs/GOIEC procedures
    - Slow, cumbersome, and costly duty- and tax-free access to imported inputs used in the production of exports under duty drawback, temporary admission, or free trade zones

  - Burdensome and costly dual exchange market and the requirement to convert 75 percent of foreign exchange earnings into Egyptian pounds
  - Extensive government interference in business activities that is costly for tax administration, safety standards, labor conditions, and other purposes
  - High transport costs and limited and uncertain availability of air cargo, ports, river and maritime transport, and truck transport
  - Costly or unavailable financing for short-term, medium-term, and long-term capital
  - Restrictive labor laws and regulations that prevent efficient use of labor resources
  - Lack of adequately trained and educated workers and managers
  - Lack of investment incentives, e.g., import duties and sales tax paid on capital goods imports
  - Costly and unreliable public utilities
- How the sector is organized and to what extent small, medium, and informal sector firms are integrated into the industry.
- Extent to which firms are connected to international supply chains and international trade and business influences
- How easily local firms can access international technology, telecommunications, and imported inputs
- Whether local firms can respond to quality and volume requirements of international buyers
- How local working conditions and environmental regulations and their enforcement compare with international standards.

The subsectors were chosen for this analysis on the basis of a combination of factors. One factor was potential competitive advantage based on export performance. Another was degree of import protection measured by import duties and quantitative trade restrictions. A third was the extent to which the industry was known for either its success in finding export markets or its fear of being challenged by import competition under freer trade.

The sectors examined include fresh fruits and vegetables, processed food, poultry, cotton, textiles and garments, furniture and other wood products, marble, ceramics, pharmaceutical products, motor vehicles, and information technology. Other sectors that were identified as being of interest but could not be included in the report because of time constraints or difficulties in meeting with industry representatives included fertilizers, cement, metals and metal products, electronic products, and financial services. Details regarding the subsector reports are contained in Appendix A.

Summary of Subsector Analysis

This section assesses the results of the subsector analyses in terms of the extent to which trade policy reform—whether unilateral, multilateral, regional, or bilateral—can be expected to offer more opportunities for production and employment or whether it is likely to create challenges for Egyptian industry. This will depend on several factors:

- Creation of new export opportunities rather than the diversion of trade from less costly to more costly sources of supply
- Exploitation of economies of agglomeration and scale accompanied by market enlargement and cost reduction
- Increased competition in import-competing industries, with resulting adverse effects on output and employment in those sectors in the short term although the longer-term impact may be more efficient allocation of scarce resources
- Increased flows of trade and FDI, which result in transfers of capital, skills, technology, and management

This analysis and the conclusion of this report assume the existence of three major options:

- No changes in Egypt's trade regime other than implementation of obligations already incurred through the signing of existing agreements and enactment of existing legislation;
- Trade policy reform through the signing and implementation of existing and additional FTAs and further commitments under WTO without any other changes undertaken in the trade regime or economic policy environment; and
- Trade reform that continues to reduce the level and dispersion of tariffs and other economic policy adjustments combined with signing and implementation of FTAs and WTO commitments.

The principal conclusions emerging from the subsector analyses are described in the following paragraphs.

FRESH FLOWERS, FRUITS, AND VEGETABLES

Because of its soils, climate, location in the Middle East, and close proximity to Europe, Egypt has a strong competitive advantage in exporting fresh flowers, fruits, and vegetables to these markets. This has been especially evident since the devaluation of the pound in early 2003, which made exports very profitable and gave rise to rapid growth, particularly in nontraditional exports such as grapes, strawberries, and cut flowers.

The major constraint on expanding these exports is market access in Europe, where import duties prohibit exports of a number of products outside the tariff rate quotas that provide limited access during seasonal windows, usually just before the harvest in Europe. The European Union–Egypt Association Agreement has expanded these openings for Egypt and provides for further consultation three years after the agreement is in effect. It is

important that Egypt press for further concessions as part of the reciprocity that should be associated with opening its industrial markets to Europe.

The importance of timely deliveries to Europe during these seasonal windows makes it imperative that Egyptian exporters have access to low-cost and reliable air freight services. Such is currently not the case because of Egypt Air floor cargo rates, regulations that discourage competition from other cargo lines, and lack of reliability of Egypt Air flights. Liberalization of air cargo transport is an important precondition for developing Egypt's competitive advantage in this sector.

Nontraditional flowers, fruits, and vegetables are grown and exported primarily by larger farmers in the Nile delta. Efforts to expand and modernize this subsector were focused on this group because of the need for quality control and because of the size of the investments and the risks involved. However, these exports are expected to have much impact on employment, smaller farmers must be involved through the enhancement of contract farmer and packing house linkages. Alternatively, small farmers may participate in fresh fruit and vegetable exports of traditional crops such as oranges, onions, and potatoes, but this will require careful attention to quality control and other requirements of export markets, including Good Agricultural Practices certification.

PROCESSED FOOD

Exportation of processed food is a natural extension of exporting fresh flowers, fruits, and vegetables by preserving these products and thus reducing the critical factor of seasonality. Exports of processed food have grown considerably, especially since devaluation in early 2003. However, more can be done to promote market access in Europe. Because processed foods are considered agricultural products, not industrial goods, Egyptian exports of these products are still subject to tariffs and tariff rate quotas despite the signing of the European Union–Egypt Association Agreement.

The principal problem in this sector is the multiplicity, arbitrariness, and variability of inspections and controls on both imports and exports of these products and their inputs. There is a multiplicity of agencies responsible for this surveillance, and much of it is not based on internationally accepted standards. The result is delays and high costs.

POULTRY

The poultry sector receives perhaps the highest protection in Egypt—through both an 80 percent import tariff and a ban on imports of poultry offal and limbs. This occurs for a number of reasons. The first is that much of the industry is inefficient, having developed in an era of heavily subsidized feeds, which are no longer available. Yet the larger, more modern farms are efficient, with conversion ratios and mortality rates that come close to those of the most efficient producers in the world.

The second problem is that of a joint product—chicken breast and chicken limbs. The first is sold for a substantial premium in industrial countries, and the second can be sold at a very low price on the world market. In Egypt, the two products sell for nearly the same price. Egypt has a difficult time competing with low-priced imported chicken limbs—thus the ban. This is especially important vis-à-vis U.S. producers, which are efficient and sell chicken parts on the world market at low prices, recovering their costs in the market for high-priced chicken breasts. This needs to be taken into account if an FTA is signed with the United States.

In the longer term, the efficient portion of the broiler industry should be able to process a larger proportion of its output in the form of cold cuts, chicken nuggets, and other prepared products, which use a higher proportion of white meat, thus enabling it to sell dark meat more competitively. According to a number of producers in the industry, these processed products could be exported profitably to Europe. The only constraint has been the failure of the Ministry of Agriculture to obtain the registration required, despite a request by the industry going back to 2002. However, expansion into this market will require better access than currently exists. In the meantime, a fairly large amount of protection on poultry offal and limbs will be required for the industry to survive. To meet WTO commitments, however, this protection should be temporary and in the form of safeguards against surges of imports rather than outright bans and high import duties. In addition, the possibility of dumping by industrial countries should be investigated because prices of dark meat in Egypt appear to be already lower, when expressed in U.S. dollars, than in the United States.

COTTON

Because of its soil and climate conditions, Egypt has a very strong competitive advantage in producing long and extra-long staple cotton, which is considered to be the finest in the world. Although there has been some tendency for world demand for this high-quality cotton to decline in the fast few years, primarily because of increased demand for leisure wear made from lower-quality cotton, there is evidence that this trend is reversing, and that the market for high-quality cotton clothing is expanding once more.

Production of cotton in Egypt declined substantially during the 1980s and 1990s, primarily because of government interference in the marketing and price structure. The government sets purchase prices for public buyers and minimum purchase prices for private buyers based more on existing stocks and the needs of the government-owned spinning mills than on world market prices. In addition, the government has an obligation to be buyer of last resort, which can result in large and deteriorating stocks when world prices are low. When this happens, the government tries to discourage planting, which is one of the reasons that production has decreased. Another is that growing rice as an alternative to cotton has been effectively subsidized because of the absence of charges for scarce water.

Because of the decrease in production and the need to maintain a certain level of exports to preserve Egypt's high-quality image abroad, spinning companies find it difficult to purchase all the cotton that they need. The Cotton and Textile Industries Holding Company

each year allocates available cotton to exports and among the spinning firms. If this is insufficient, spinning production may have to come to a halt, which can be very disruptive to the firms. This not only affects the spinning industry but also has adverse effects on weaving, dyeing, finishing, and garment and home-furnishings manufacture.

One problem is that Egypt uses much of its high-quality cotton to produce garments and home furnishings that are sold locally at prices that are low in comparison with what Egypt's cotton and high-quality goods made from that cotton should command on world markets. It would be better to encourage importation of lower-quality cotton for this purpose. For example, in 2002, Egypt imported $20 million of medium and short-staple cotton to be processed into medium- and low-priced products, almost all of which were sold on the domestic market. This practice is discouraged, however, by the phytosanitary and other restrictions that have been placed on cotton imports.

The cotton sector is not likely to be affected directly by any FTAs in place or being considered, because Egypt's high-quality cotton enters most markets duty-free. Egyptian cotton would be more price-competitive, however, if there were progress within WTO on reducing subsidies on cotton production in Europe and especially the United States. However, experts agree that the major reason for the decline in the area devoted to cotton production in Egypt is government policy failures rather than low prices on the world market.

TEXTILES AND CLOTHING

The spinning-dyeing, finishing-weaving, and knitting apparel industry in Egypt consists of two different subsectors with different potential gains and losses from free trade. One is the making of mid-market apparel, largely for export, from imported materials; the other is an integrated industry based on the transformation of Egypt's high-quality cotton into yarn, fabrics, and garments, mostly for the domestic market.

Egyptian exports of garments consist mainly of medium-quality men's and women's casual wear made of cotton or cotton blends and men's and women's wool suits. Most high-quality garments made of Egyptian cotton that are imported by the European Union and United States are made in other countries, not Egypt, a trend that should be reversed. Bed, table, toilet, and kitchen linens are also a significant export category accounting for $90 million of revenue in 2002.

Under the International Agreement on Textiles and Clothing, all quantitative import restrictions are supposed to be eliminated at the end of 2004. This could present Egyptian exporters with a major challenge in both the EU and U.S. markets. Industry experts believe that the United States will invoke safeguard provisions. This action has been taken already in a couple of clothing categories affecting mostly China and Vietnam. However, use of safeguard measures under WTO should be temporary only and should involve compensation to the exporters.

If the United States does abide fully by the agreement, Egypt's exports of medium-quality garments will be severely threatened. Lower-cost producer countries will be able to export more garments to the United States, potentially reducing Egypt's market share and export revenue. An FTA with the United States might help increase Egypt's competitiveness, but this would depend on the rules of origin, specifically what percentage of the garment would have to originate in Egypt to receive tariff-free status and how this percentage would be defined. Still, Egypt has an opportunity to export more garments to the European Union under new rules of origin allowing cumulating among Mediterranean countries, some of which are sources of inputs for garment manufacturers. Unless Egypt can obtain substantial concessions from the United States on rules of origin, exporters of mid-market apparel may find themselves concentrating on the European market.

There also appears to be a good opportunity to increase exports by upgrading production of high-quality apparel and bed and table linens made from Egypt's superior cotton. Egypt is already vertically integrated, doing everything from growing the cotton to making the garment. However, this sector does not obtain all the value that it could because it uses high-quality Egyptian cotton to produce medium-to-low–quality textiles and garments for the local market. Egypt could develop a high-value integrated subsector that transforms extra-long and long staple cotton into fine-quality, high-end shirts, blouses, dresses, bed linens, and infants' and children's clothes, some with designer labels. Egypt has the elements, including a logo, to dominate this market niche where there is much less competition than in the mid-market and much higher margins for companies in each stage of manufacturing. Marketing should not be a problem as long as some of the world's major high-quality brands and retail firms are brought into the process to ensure that clothing is made according to their specifications. These exports would comply with existing rules of origin and would not be as vulnerable to competition as medium-quality products. Other benefits would include more jobs for the industry and for support industries such as marketing and export agencies, training and consulting specialists, machinery repair and spare parts, IT services, etc.

For the high-quality integrated textile and garment industry to thrive, it will need government support in a number of ways. Government-owned factories need to be privatized or upgraded with investment in new equipment, new methods based on world standards, and training of employees. A major need is to update and improve the quality of dyeing and finishing. Efficiencies must be improved and work processes streamlined even if some employees lose their jobs. This is critical. If this is not done the competitive advantage of the highest-quality cotton in the world is wasted. To thrive in a global marketplace, this industry will need access to capital for equipment, marketing expenses, general working capital, and reasonably priced hard currency for equipment and raw material purchases (dyes and finishes, trims, etc.).

The medium-quality apparel industry will benefit from lower tariffs in the European Union or United States on raw material imports. But it will be vulnerable to the reduction of tariffs on ready-made garments. With greater competition in the domestic market and export market, private sector companies will need to become more efficient. Government

enterprises in this sector must also be upgraded or privatized. The elimination of the sales tax on imported equipment and reduced customs fees and procedural delays would also help cost competitiveness.

To be globally competitive, exporters of apparel must meet customers' demand for short turn-around times from order placement to delivery of goods. Delays in transportation and customs procedures for imports and exports, as consistently experienced now, can prevent Egyptian companies from meeting industry-standard deadlines. Foreign buyers will not tolerate slow deliveries. They will simply source their goods elsewhere.

FURNITURE AND WOOD PRODUCTS

The wooden furniture industry is characterized by thousands of producers, mostly SMEs made up of skilled craftsmen, with revenue of $230 million per year. A small percentage of producers (13 percent) export their furniture, primarily to the United States, European Union, and Arab states. Egypt has some competitive advantages in the global marketplace, particularly hand carving and crafting of antique reproductions. In 2002, Egypt furniture exports were valued at $30.5 million. Industry sources estimate that in 2003, $20 million was exported to the U.S. tariff-free because the hand-carved designs on the furniture caused it to be categorized as handicrafts. Other exporters benefit from reduction in tariffs on furniture exported to the European Union and Arab states and would also benefit from similar reductions in the event of a United States-Egypt FTA.

Most producers make furniture for domestic consumption. This subsector would be hardest hit by an FTA with the United States because it would lose its current protection in the form of a 40 percent tariff rate on imported furniture. According to some industry experts, this subsector would not be able to compete with mass-produced, low-cost furniture coming from the United States, or for that matter from Asia, without tariff protection. Thus an FTA with the United States will have to provide adequate safeguards against a surge of imports and a reasonably long period of time for adjustment similar to the European Union Agreement. Without this, given the labor-intensive nature of production and the scale of activities, the effects on employment would be devastating.

Egypt faces significant problems in developing furniture exports. A number of these are discussed later as generic problems facing all sectors, but they are particularly relevant to the furniture industry because of the structure of the industry and the fact that many of its firms are SMEs.

One problem is the high cost of imported equipment, spare parts, raw materials, and intermediate inputs. The wood furniture sector relies on the importation of virtually all its wood and finishes, mostly from the European Union. These companies will benefit greatly from tariff reduction under the European Union–Egypt Association Agreement—from tariff rates that currently range from 5 percent to 40 percent. An FTA with the United States might provide further benefits. However, these gains will accrue only if significant progress is made in reducing other costs associated with these imported inputs such as unrecovered

sales taxes, import surcharges, storage fees necessitated by administrative delays, and other problems associated with customs and port clearance. Added together, the total cost increase resulting from these constraints is estimated at 50 percent of the CIF value of the inputs, a large burden on competitiveness.

Aside from costs, there is great frustration, especially for smaller exporters, in dealing with ever-changing customs rates, requirements, and procedures. This can easily discourage these companies from exporting. Larger firms may be able to deal with these problems better because they are more knowledgeable about the procedures and have access to those who can facilitate the process.

SMEs lack access to capital for equipment purchases, market development, and working capital, which is essential to growth. In early 2004, the Export Development Bank and the Ministry of Foreign Trade announced a project to allocate £E10 million to SME furniture companies. If implemented, this would be a good first step, but more sources specializing in different types of financing will be needed.

There is a lack of cooperation within the industry to improve marketing intelligence, design capability, and distribution contacts by sharing information and costs among SMEs. Being small, Egyptian companies in this industry would benefit a great deal from collaborating with each other. The Industrial Modernization Centre has been working with formal and informal furniture factories and workshops towards this end, such as by establishing a technology information center. One benefit could be the development of incubator infrastructure, including website design, which is important for international marketing.

PHARMACEUTICAL PRODUCTS

The pharmaceutical industry in Egypt dates back to the early years of the 20th century. This history has allowed it to develop economies of agglomeration and scale, which give it a distinct advantage over some other industries. However, the industry is at present in serious trouble. This is because retail prices of pharmaceutical products have been fixed at the same level for about 10 years. Given the heavy dependence of this sector on imported inputs and the rise in the prices of these inputs associated with recent devaluation, profits have disappeared, and heavy losses are being experienced. The industry is rapidly decapitalizing, and firms will soon start going out of business.

One alternative is for these firms to orient their production more towards the export market, where price controls are less constraining. This is already occurring. Ultimately this situation will lead to the collapse of both local production and official importation for the domestic market. Instead, pharmaceutical products will be smuggled into Egypt and sold on the parallel market at whatever prices consumers are willing to pay. This will make it difficult to control the quality of these products.

The other problem in this industry that was identified, but pales in comparison with the problems posed by low fixed retail prices, relates to lack of clearly defined intellectual

property rights. This has discouraged investment by multinational corporations, but the situation could change with the new IPR law that was recently passed.

CONSTRUCTION MATERIALS—MARBLE AND CERAMIC TILES

Marble and ceramic tiles have been two of Egypt's most successful exports, with prospects for significant additional growth. In 2002, Egypt was the third-largest exporter of marble in the world, and its exports were growing very rapidly relative to total world imports, suggesting that Egypt has a sizeable competitive advantage in the industry. The quality of Egyptian marble is very good because of the country's warm, dry climate. Quantities are almost limitless, and the costs from quarry to market are much lower than those of the competition partly because of the devaluation of the Egyptian pound. Egypt's exports are displacing those of Italy, Spain, and Turkey, whose quarries are old and of diminishing quality and have higher labor costs. Production of ceramic tiles, however, still depends on imports of glazes and stains, as well as on the design work done in Italy and Spain.

Demand for marble and ceramic tiles is expanding rapidly, especially in the United States as consumers move away from cheaper materials. Egyptian marble can compete easily on price in the United States, and ceramic tiles should also be able to compete very well, once the market is better developed, despite a 10 percent tariff. The ceramic tile industry would be delighted if an FTA were signed with the United States that would eliminate this tariff to give this industry a larger price advantage vis-à-vis competitors or to increase its margin of profitability.

In 2002, more than 90 percent of marble exports went to China and Italy as blocks. There they were cut into tiles and slabs, polished, and finished before being shipped to their final destinations, primarily the European Union and United States. This processing could be done locally if Egyptian companies had the capital to invest in cutting equipment that is essential to produce a finished product. Even when quarrying stone, producers should replace explosives, which destroy several tons of marble for every ton that is usable, with efficient diamond-tooth cutting machines.

Some of the larger marble companies now have this equipment and are beginning to establish production lines. They are increasing their export sales and doing well. But most companies in this sector are SMEs with the potential to export but not the means. They need greater access to bank loans for equipment purchases and increased working capital. Smaller companies would benefit from working together to share costs and information about the needs of foreign markets, marketing, distribution, shipping, and improved processing methods. The same applies to the ceramic tile industry.

Standards are important in the marble industry, and starting January 1, 2005, no Egyptian marble will be allowed into the European Union unless it has met the requirements for the CE mark. Each Egyptian company wanting to export to the European Union will have to go through the application and investigation process and incur about € 20,000 in cash cost. This will have the effect of discriminating against smaller firms.

This industry is particularly vocal in its complaints regarding the slowness and complexity of customs procedures, arbitrary valuation, payment of duties and sales tax on equipment, and assessment of an import surtax. Even exporters complain that the people who approve export clearances are so slow that shipments sometimes miss the scheduled boat, which can delay the completion of an entire big construction project.

The marble industry has some unique needs that the government should address to facilitate business operations. Roads in the vicinity of the quarries are in bad condition and need to be improved to reduce accidents and other safety problems and to lower the high cost of vehicle repair. Unnecessarily frequent administrative procedures include short leases with frequent and sometimes confusing renewals. Every six months quarries must have approval from the military authority to use explosives. These are often delayed, leading to uneven production scheduling and increased costs.

MOTOR VEHICLE ASSEMBLY

Motor vehicle assembly in Egypt is one of its most highly protected sectors, with an import duty of 135 percent assessed on many imported automobiles. Much of the industry is state-owned, although multinationals also participate. Under the European Union–Egypt Association Agreement, Egypt has 15 years to eliminate its tariffs in this sector, which is an unusually long period of time.

Nevertheless, some areas in the sector are relatively efficient. One department of a larger state-owned firm, which assembles buses, trucks, and small tractors, was hived off the larger firm, which absorbed all debt and redundant labor. The new firm has been making a profit for three years and has even exported. It is looking to be privatized. This appears to be an innovative approach to revitalizing some of Egypt's less-efficient industries.

The import duty on trucks and buses is 40 percent, which still offers considerable protection and raises the cost of truck and bus transportation in Egypt. However, the duty on tourist buses is only 5 percent, as an incentive for that industry. These buses, in fact, have negative effective protection. Industrial sources assert that all this vehicle assembly could compete with zero tariff protection if they had some assistance in improving the organization of their factories.

Assembly of buses is labor-intensive and makes extensive use of local components such as metal panels, which are assembled onto the chassis by hand. Many of the assembly-line operations for these vehicles, in fact, are labor- and skill-intensive. Furthermore, many of the components for a number of product lines use locally produced components, perhaps because of government financial incentives.

INFORMATION TECHNOLOGY

Information technology (IT) is one of the most important sectors in Egypt today, both for the export of IT products and services and because it is key to the success of all other sectors.

Egypt must currently rely on foreign technologies for growth in IT infrastructure. The United States supplies more than three-quarters of Egyptian IT imports. An FTA with the United States, leading to the reduction of import tariffs on computers, could increase their usage by businesses, especially SMEs. Even without this FTA, however, Egypt is a signatory to the Agreement on Information Technology, and as such has an obligation to eliminate all customs duties on computer equipment by 2007. Most duties will be eliminated by 2005.

Egypt does not have the capability to create new IT hardware technologies; neither is it positioned to compete on a large scale with China and other Asian manufacturers of hardware. However, software and IT services businesses could be successful and should be encouraged.

The government recognizes this and has created initiatives to teach more students IT, including subsidized training centers, but there is some question about the quality and appropriateness of the training in relation to the needs of the job market. Well-trained students cannot always find good jobs in Egypt so they often move to other countries. Thus Egypt loses some of its best and brightest IT specialists.

Other government initiatives include tax free zones and tax incentives, but these have not been used well. To encourage the development of the IT industry, Smart Village and City Stars have been created. While there are tax and tariff advantages for an IT company to be located in Smart Village and City Stars, there are other advantages to being in a free zone, including no tariffs paid on inputs and the right to have 100 percent foreign ownership of the company. Government initiatives often go unutilized because of bureaucratic obstacles and unreasonable collateral requirements.

Piracy is a big problem. Intellectual property legislation has been passed to protect software developers and now must be consistently enforced.

Having taken the first step by launching these initiatives, the government must make them more accessible and beneficial to the industry. A frequently heard complaint is that programs have been established but are not funded or implemented.

Software and IT services are well-suited to the creation of new small businesses because economies of scale are not very important. However, there may be significant economies of agglomeration, which is one of the reasons why the government is trying to induce firms in this industry to group together. The main problems for entrepreneurs are the cumbersome and expensive procedures to start and register a new business and the difficulty of

obtaining access to working capital, because they often have no credit history and banks are reluctant to use computers or other business equipment as collateral.

A couple of Egyptian companies have begun to create and export software in Arabic, and others should be encouraged to do the same. According to software experts, Egypt has tremendous potential in the localization, customization, and consulting. Localization consists of adapting an existing software product to the Arabic language and to customs in Arabic and Middle Eastern countries to give a local look and feel to the software. The Software Export Development Organization is responsible for promoting software exports and assisting developers in marketing their products globally. Egypt also has considerable potential for e-commerce, in the form of data entry and technical services in the Arab states. For example, Egyptian companies could take an Arabic data-entry business from Dubai and Jordan where labor and other costs of doing business are significantly higher. However, legislation is required to set regulatory standards for the industry.

GENERAL CONSTRAINTS COMMON TO ALL SUBSECTORS

A number of constraints are common to virtually all subsectors and complaints about them are common. Many of these constraints affect SMEs in particular, and these companies do not have the resources to deal with cumbersome administrative requirements or the contacts to facilitate dealing with them.

Foreign Exchange. One constraint is the nature of the foreign exchange market. Firms are required to convert 75 percent of their net foreign exchange earnings into local currency at the bank rate of exchange. Yet when they try to recover the foreign exchange for the purpose of purchasing inputs or other needs, they must follow complex procedures and experience long delays. As a result, they usually end up obtaining foreign exchange on the parallel market at a significant loss.

High Cost of Imported Inputs. The cost of importing machinery, spare parts, raw materials, and intermediate inputs is high because of customs duties, sales tax, special import surcharges, port fees, port delays resulting in storage fees, customs officials requiring a receipt certified by the Egyptian embassy in the country of origin to establish value, and GOIEC procedures that are slow, cumbersome, and costly. Many of these taxes and other fees are not deductible when final products are exported. Nor is there any incentive scheme whereby expenditures on capital equipment can be considered as a credit against corporate profits tax.

Arbitrary Customs Valuation. Another problem cited by virtually all subsectors is customs valuation, which is frequently arbitrary and based on price lists that have little to do with prices actually paid. This is in violation of the transactions approach to valuation, which Egypt has subscribed to as a member of WTO. Smaller exporters especially feel frustration at dealing with always-changing customs rates, requirements, and procedures.

Duty Drawback and Temporary Admission. Duty drawback and temporary admission procedures either do not work or are so complex and lengthy that many firms do not bother to use them. This is especially a problem for smaller firms.

Access to Finance. SMEs especially lack access to capital for the equipment purchases, market development, and working capital that is essential to growth. SMEs generally self-finance, thus limiting their opportunities to small incremental gains that prevent them from being significant players in the global marketplace.

Lack of Cooperation among Firms. There is lack of cooperation among firms to improve marketing intelligence, design capability, and distribution contacts by sharing information and costs. Many companies do not realize that, when exporting, the competition is a company in another country, not in Egypt.

5. Conclusions and Next Steps

Conclusions

Egypt has made rapid strides in expanding exports of goods other than petroleum. These have more than doubled in the past seven years. At the subsector level (fresh flowers, fruits, and vegetables; processed foods; ready-made garments; wool suits made in vertically integrated enterprises; marble and ceramic tiles; computer software) many individual companies have seized opportunities in different export markets. Most of these industries have required substantial adjustments to meet the high quality standards of foreign markets. In some cases they have received assistance from foreign companies or local professional associations. Even when the competitiveness of these industries is based in part on the advantage of good natural resources, developing this advantage has required education, technical and management skill, and other forms of human capital that Egypt has in some abundance. All of these exporting industries would benefit from freer trade, whether as a result of unilateral action or multilateral, regional, and bilateral agreements.

Other sectors have significant problems that could expose them to injury from freer trade. Often these industries are very labor-intensive but make products of low quality for the domestic market and might have a difficult time competing with cheap labor-intensive or mass-produced imports from Asia or even the industrial world. An example is Egypt's very labor-intensive furniture industry, which could be injured by imports of low-quality furniture. Used clothing imports are another example. Although Egypt might be able to produce labor-intensive goods for export, the country does not appear to be very competitive at the lowest level of skills. Rather, Egypt's comparative advantage seems to lie in combining low-cost labor or natural resources with higher-level technical and managerial skills. One example might be integrated, high-value cotton garments. Another might be electronic assembly. Still another is marble and ceramic tiles.

Egypt does appear to have some advantages in exploiting economies of agglomeration and scale. This is probably true in textiles, industrial chemicals, pharmaceuticals, metal and metal products, and motor vehicle assembly. If these industries can be restructured and modernized, they may be able to establish a significant competitive advantage in the region.

Egypt runs the risk of being driven by the rent-bearing sector, in which most of the supply of foreign exchange is fixed independently of costs and is variable depending on the world market for petroleum and on the political and military situation in the Middle East. Distribution of benefits from the earnings of this sector tends to be unequal, resulting in large demand for imports by middle- and upper-income groups. Given that industrialization goes back to the 1930s and received strong impetus under President Nasser, pressures for protection have been strong in this area. This has tended to discourage imports of manufactured consumer goods and to favor the importation of producer goods and food, which are also inelastic with respect to price and not cost sensitive (e.g., machinery for the petroleum industry, electronic machinery and equipment, cereals, motor vehicles, aircraft, iron and steel). The result has been substantial appreciation of the real exchange rate independent of the cost structure of the economy. This could have serious consequences for sectors in which cost is an important element of competition (e.g., cheap furniture, low-quality clothing, poultry parts). It could also penalize exports.

If tariffs continue to decrease and the Egyptian economy becomes less protected, both exports and imports can be expected to increase, with exchange rate equilibrium being determined much more by costs, especially on the import-competing side, than at present. With lowering of tariffs in the presence of a free exchange rate, it is likely that imports will expand first, causing the exchange rate to depreciate, which will cushion the blow of tariff reduction on sectors that are particularly vulnerable. However, time will be required (1) for price signals to work their way through the marketing system until consumers respond to lower import protection, and (2) after that response has taken place and the exchange rate has depreciated, for producers to adjust. This could take several years, implying that no matter what the process for achieving trade policy reform, the time allowed for adjustment should be reasonably lengthy.

The choice of which approach to use—unilateral tariff reduction and trade liberalization, multilateral negotiations associated with WTO, or pressing forward with regional and bilateral FTAs—is a complex one and involves political as well as economic considerations. In the end, probably all three approaches should be used because they are somewhat complementary. Furthermore, Egypt has already undertaken unilateral action, made commitments under WTO, and signed several regional and bilateral trade agreements. For the most part, the analysis in this report suggests that these should have largely positive effects if time is allowed for adjustment, adequate safeguards are used to protect vulnerable sectors, and complementary policy reforms are put in place to ease the process of transition.

Furthermore, the evidence from Egypt and elsewhere suggests that continuing the negotiation and signing of FTAs (for example, with the United States and SACU) has distinct advantages. These advantages go far beyond those directly related to trade. They include the FDI that is likely to be attracted, the technology and managerial skills that will be transferred, and the increased confidence that tourists and others will have in coming to Egypt. But perhaps most important, it will reinforce the position of the young, outward-looking entrepreneurs in Egypt, who are the ones who will ultimately cause Egypt's economy to grow and link its destiny with the rest of the world.

If Egypt is to maximize its benefits from tariff reduction and trade liberalization—whether through unilateral, multilateral, or regional/bilateral approaches—it must put in place the complementary infrastructure, institutions, and policies necessary to achieve as painlessly as possible the reallocation of resources that is required. These include upgrading of port, airport, and transportation systems; simplifying regulatory controls and administrative procedures; reducing government interventions in price and marketing systems; increasing access by SMEs to financing; privatizing public enterprises or at least upgrading them to higher levels of efficiency; improving the efficiency of the market for foreign exchange; improving tax incentives for exports and investment; and ensuring adequate and appropriate education and training of workers and managers for participation in the global economy.

Egypt's policymakers need information on the effects on the local economy of all these trade policy actions and agreements to devise strategies for preparation, negotiation, and implementation (Salinger *et al*. 2003). The approach used here is to try to understand, in a short period of time, the dynamics of key subsectors. This approach has revealed some surprises regarding the vitality of every subsector if the needed infrastructural, institutional, and policy support can be supplied.

The investigation thus far has been based on interviews with only a few leaders in each industry. Some important industries have not been covered. There is a need to extend the range of contacts to hear varying opinions and achieve wider coverage. There is also a need for greater quantification of the effects of trade and economic policy reform on various subsectors. One practical approach lies in the estimation of single-market consumption, production, trade, and employment effects. The logical connections among sectors can then be outlined to give policymakers a sense of how these partial impacts would be connected in a broader, economy-wide context.

Next Steps

The analysis in this report suggests that Egypt would make substantial gains from further trade policy reform through (1) signing and implementing existing and additional FTAs, (2) making further commitments under WTO, and (3) unilaterally reducing tariffs and nontariff barriers as well as making other economic policy adjustments. There would also be costs, especially in the short run, as resources are reallocated to sectors in which Egypt has a competitive advantage, although these costs can be lessened and benefits increased if other economic policy reforms are undertaken to establish a good business environment.

What follows is a practical approach to reform that would enable Egypt, during the next few years, to benefit from the opportunities and challenges of the changing global trade regime while taking into account the time required for internal restructuring, either to shift resources out of product lines in which Egypt does not have a comparative advantage or to rehabilitate these so as to make them more competitive. In many cases, the analysis has

shown that it should be possible to shift resources among product lines in a particular subsector rather than abandon the subsector altogether.

Egypt has already embarked on an extensive program of tariff reduction under its Association Agreement with the European Union, especially as this applies to industrial goods. In addition, as a member of WTO, Egypt is committed to removing a number of nontariff barriers described earlier. It is also committed to moving ahead with multilateral trade reform, although that process has slowed somewhat following the meetings in Cancun. Aside from these major commitments, Egypt is party to other regional and bilateral agreements, including GAFTA and COMESA. Other future options include FTAs with the United States, SACU, and Mercosur.

This wide array of agreements poses a significant challenge. For example, it could create a tariff schedule of enormous complexity—with duty rates differing not only by product code but also by country of origin. Policing this schedule would require complex rules of origin. As we have seen, Egypt's customs service already has significant problems overseeing the application of existing rules. These problems could easily get worse.

A second major problem is that by eliminating tariffs on trade with some countries and not others, Egypt could experience substantial trade diversion. For example, if agricultural machinery was initially imported from the United States because of low cost and good quality, and then imports shifted to the European Union because tariffs on imports from the European Union were eliminated, overcoming the competitive advantage of the United States, Egypt would lose by having to pay more for its machinery.

These are strong arguments for establishing FTAs with Egypt's major partners that apply the same program of tariff reduction. Because the European Union–Egypt Association Agreement is the most important agreement that Egypt has, this should be the model on which other agreements are based. Exceptions could be made for industries that would be particularly threatened by imports from outside the European Union, but these would be justified on an ad hoc basis according to the threat imposed. For example, the small-scale furniture industry in Egypt might be threatened more by an FTA with the United States than by the existing agreement with the European Union, in which case a longer period of protection from U.S. imports might be desirable.

The other major exception is agriculture. The Association Agreement with the European Union is very specific about tariff rate quotas on Egypt's of agricultural-product and processed-food exports to the European Union. Although some concessions have been granted in the agreement, continuing discussion of further concessions is planned. In addition, unlike for industry, there is no scheduled program for tariff reduction on agricultural products outside the tariff rate quota for either Egypt or the European Union. This presumably has also been left to future negotiations. How agriculture is to be handled as part of other FTAs is unclear, but, again, where there is particular sensitivity, it is likely that special measures will have to be taken—for example, the import of poultry offal and

limbs, which is currently banned while poultry in general is subject to a tariff rate of 80 percent (here the threat is likely to be the United States).

In negotiating other FTAs, Egypt might consider the possibility of reducing tariffs for agricultural products in exchange for other concessions. For example, SACU has a tariff of 20 percent on imports of ceramic tiles. Egypt could benefit from the elimination of this duty.

Table 5-1 presents, for a sample of products of the subsectors studied, the current tariff, the WTO tariff binding, the tariff program agreed on with the European Union for industrial goods, and proposed tariff reductions for agricultural products and processed foods. These could be applied not only to the European Union–Egypt Association Agreement but to future FTAs as well.

Table 5-1
Current Tariff Rates and WTO and other FTA Commitments

HS Code	Description	Current Tariff Rate	Trade Agreement Commitments						
			Bound Duty	FTA					
				2002	2005	2008	2011	2014	2017
FRESH FRUITS AND VEGETABLES									
070190	Potatoes, fresh or chilled nes	20	20	20	15	10	5	0	0
070200	Tomatoes, fresh or chilled	20	20	20	15	10	5	0	0
0703	Onions, garlic and leeks, fresh or chilled	20	20	20	15	10	5	0	0
0712	Dried vegetables	30	40	30	20	10	5	0	0
080510	Oranges, fresh or dried	40	60	40	30	20	10	0	0
080610	Grapes, fresh	40	60	40	30	20	10	0	0
PROCESSED FOODS									
2005	Prepared or preserved vegetables nes	30	45	30	20	10	5	0	0
2007	Jams, jellies, marmalades	40	60	40	30	20	10	0	0
POULTRY									
0207	Meat & edible offal of poultry meat	80	80	80	80	70	60	50	40
MARBLE AND CERAMICS									
2515	Marble, travertine, ecaussine etc,	15	15	15	15	14	7	0	0
6908	Glazed ceramic flags and paving, hearth and wall tiles; mosaic cube	30	60	30	30	27	14	0	0
PHARMACEUTICALS									
3004	Medicament mixtures (not 3002, 3005, 3006)	10	5-10	10	10	9	5	0	0

Table 5-1 (continued)

HS Code	Description	Current Tariff Rate	Trade Agreement Commitments						
			Bound Duty	FTA					
				2002	2005	2008	2011	2014	2017
FERTILIZERS									
3102	Mineral or chemical fertilizers, nitrogenous	30	40	30	30	27	14	0	0
COTTON									
520100	Cotton, not carded or combed	5	5	5	0	0	0	0	0
TEXTILES AND CLOTHING									
5205	Cotton yarn	12 (30)	15	12	10.8	5.4	0.0	0	0
5208	Woven cotton fabrics	22 (54)	30	22	22	20	10	0	0
5702	Carpets, not tufted	40	60	40	40	36	18	0	0
6109	T-shirts, singlets and other vests, knitted or crocheted	40 (spec)	40	40	40	36	18	0	0
6204	Women's suits, jackets, dresses skirts etc & shorts	40 (spec)	40	40	40	36	18	0	0
6302	Bed, table, toilet and kitchen linens	35 (spec)	35	35	35	32	16	0	0
METALS AND METAL PRODUCTS									
7208	Flat-rolled products of iron/non-al/s width>/=600mm, hr, not clad	20	30	20	20	18	9	0	0
7606	Aluminum plates, sheets and strip, of a thickness exceeding 0.2 mm	30	40	30	30	27	14	0	0
8544	Insulated wire/cable	30	40-60	30	30	27	14	0	0
MOTOR VEHICLES									
8703	Cars (incl. station wagon)	135	60–160	135	135	122	81	41	0
8704	Trucks, motor vehicles for the transport of goods	40	20–60	40	40	36	18	0	0
FURNITURE AND OTHER WOOD PRODUCTS									
9403	Other furniture and parts thereof	40	60	40	40	36	18	0	0

Traditional horticultural crops (potatoes, tomatoes, onions, garlic, dried vegetables, and oranges) are competitive not only in the domestic market but the export market. The same is true of nontraditional horticultural crops such as grapes, strawberries, and cut flowers. Exports of most of these products have increased in the past few years (see Table 2-1). Tariff rates of 20 –40 percent do not appear necessary and could be phased out in return for tariff concessions by FTA partner countries. It may even be possible to use these tariff reductions to obtain concessions on horticultural crops entering the European market, which is by far Egypt's most important export market for these products. In addition, solving the problems

of air transport would do much to make this industry even more competitive in the European and other markets.

Egypt is less competitive in processed foods, although exports have expanded substantially, especially since devaluation. If the problems of complex and unpredictable port clearances could be solved, this industry should be able to compete successfully in both domestic and export markets at the tariff rates proposed in Table 5-1.

Poultry is a particularly sensitive industry, primarily because the United States exports poultry offal and limbs at very low prices because it recovers most of its costs on sales of chicken breasts in its domestic market. Egypt may be able to adapt to this market by increasing its exports of white meat in the form of cold cuts and other processed products, but this will take time. In the meantime, the first priority should be to eliminate the ban on imports of poultry offal and limbs, which is clearly in violation of WTO commitments. If necessary, recourse can be had to WTO's safeguard clauses to protect against a sudden surge in imports. Over time, the situation can be reviewed to see whether further tariff reductions are warranted beyond the limited reductions proposed in Table 5-1.

Marble and ceramics are two industries in which Egypt appears to have a clear comparative advantage, judging by recent export trends. The slow pace of tariff reduction scheduled in the European Union–Egypt Association Agreement is probably unnecessary. Egypt could use this as a bargaining chip in tariff negotiations with SACU or the United States.

Tariff protection on pharmaceuticals is very low even at present. The problem is not tariffs but controlled prices. If these are not raised, neither imports nor domestic production for the local market will be profitable.

Although this industry was not analyzed in detail for this report, Egypt appears to have a strong comparative advantage in nitrogenous fertilizers, largely because of its low energy costs. Exports in 2002 were $124 million, whereas imports were only $3 million. Thus there is little reason for tariff rates to be as high as they are. Again, this could be an industry in which Egypt agrees to make tariff concessions that are greater than those of the Egypt–European Union Agreement.

The cotton-textiles-clothing value chain exhibits high escalation, that is, tariff rates increase as one moves up the chain. Egypt has recently agreed to substantial tariff reductions as part of its WTO commitments—moving from specific tariffs on a number of product lines (with very high ad valorem equivalents) to much lower ad valorem duties. When these agreements are implemented, which should be as soon as possible, the industry will experience sharply increased competition. However, this is an industry with abundant opportunities, although substantial adjustments need to be made. These will require (1) freeing up the marketing and pricing of raw cotton; (2) encouraging importation of short- and medium-staple cotton for the domestic market; (3) reducing restrictions on purchases of imported cotton by spinning mills; (4) modernizing spinning, weaving, and especially finishing and dying; (5) encouraging integrated production of high-quality apparel and home textiles made from long and extra long-staple Egyptian cotton; and (6) improving

access by clothing exporters to tax-free imported fabrics and other inputs. If these reforms are undertaken, there is no reason the tariff reduction schedule in the European Union–Egypt Agreement cannot be met.

The metal and metal products industry also has substantial scope for reallocating resources within the industry in ways that will improve competitiveness. For example, exports of flat rolled iron products have increased rapidly in the past few years, whereas other products, such as bars and rods, have not fared as well. Aluminum and its products have also done nicely. Although it was not possible to study this subsector in detail for this report, the record on trade suggests that the industry can be competitive. Therefore, the tariff reduction schedule set out in the Egypt–European Union Agreement seems reasonable.

The motor vehicle industry is another industry with substantial opportunities as well as challenges. Although the import duty on passenger cars of 135 percent is higher than for any other product, the industry manufactures buses, trucks, and tractors as well, and reasonably efficiently, carrying a duty of only 5 –40 percent and exporting some of these products. In addition, the industry has substantial linkages with smaller suppliers. What this industry requires is a combination of upgrading efficiency to achieve the potential for competitiveness, reallocating resources to the most competitive activities, and eliminating activities that are unlikely to ever be competitive. This is a big industry, and this process is going to take time. This is allowed for in the European Union–Egypt schedule of tariff reduction. In the end some factories may have to be closed, but by that time most of their employees should be able to retire or find other jobs.

There is scope in furniture and other wood products for modernization and reallocation within the industry. However, this will not be as easy as in some industries because a large part of the subsector is made up of small-scale firms producing cheap furniture for the low end of the domestic market. Care must be taken to see that these firms are not suddenly faced with sharp competition from cheap imports, because the effects on unemployment could be severe. The tariff reduction schedule set out in the European Union–Egypt Association Agreement must be monitored closely and assistance must be offered to ensure that the industry can make the adjustments required. In addition, special protection may be required vis-à-vis cheap furniture imports in the event that an FTA is signed with the United States.

Although the IT industry is not shown in Table 5-1, it is worth saying a word about it. Egypt has signed the Agreement on Information Technology and will eliminate tariffs on computer equipment by 2007 accordingly. It also has made commitments regarding telecommunications services under the General Agreement on Trade in Services. The European Union–Egypt Association Agreement calls only for cooperation in the IT domain. The IT subsector is already substantially liberalized so that further commitments, whether to WTO or under FTAs, are unlikely to have much impact on the sector.

These observations and recommendations are made for only a few product lines in the subsectors chosen to provide a detailed analysis. Nevertheless, the principles on which they

are based should apply to a broader segment of the Egyptian economy, although verification of this would require more subsector studies.

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Appendix A. Subsector Studies

A1. Fresh Fruits and Vegetables

Fresh fruit and vegetable exports from Egypt were valued at $232 million in 2002, with growth from 1998 to 2002 at about 7 percent per annum. The European Union is the most important destination for most of these exports, with the Arab states providing the largest market for oranges and onions. Europe is the biggest market in the world that does not have stable, year-round supplies of fresh horticultural products at reasonable prices. Egypt has the natural advantages of close proximity to the European and Gulf markets, ideal climate for growing fresh fruits and vegetables, and low-cost labor. Egypt's major competitor in the European market is Morocco, which has lower transportation costs by truck or by 40-foot container shipped by sea (World Bank 2001, 34, 37).

The horticultural export sector in Egypt is characterized by two quite distinct subsectors:

- Non-traditional export crops such as grapes, strawberries, fine green beans, and cut flowers, which are produced primarily for export, are carefully packed, have generally large margins, and are grown on relatively large farms with good quality control;
- Traditional crops such as tomatoes, potatoes, onions, and oranges, which are produced primarily for the domestic market, are generally sold in bulk, have much smaller margins, and are grown on relatively small farms.

The difference between the export performance of the two types of crops, shown in Table 4-1, is very striking. Exports of grapes, strawberries, and other vegetables increased over the period 1998-2002 at annual rates from 30 percent to 46 percent. This was vastly in excess of the growth of the world market for these crops, indicating Egypt's very strong comparative advantage.[30] On the other hand, the annual rate of change of exports of traditional horticultural crops was anywhere from -8 percent to +10 percent. It is important to recognize, however, that the value of the traditional horticultural exports far exceeds that of non-traditional exports, so that even relatively modest rates of growth, such as 7 percent for oranges, can contribute substantially to output and employment. Furthermore, there is

[30] It is also due to USAID's interventions in this area through the Agricultural Technology Utilization and Transfer (ATUT) project.

some risk that the markets for some of the non-traditional exports may become saturated if Egypt maintains its present rate of export growth (DAI 2002, Vol. II, pp. 78-79).

Table 4-1 also presents information on access to the European market under the terms of the EU-Egypt Association Agreement. For example, new potatoes enter the EU market with a 100 percent reduction in duty, up to a quota of 250,000 tons, during the period 1 January to 31 March, after which they pay the full duty rate of 14.4 percent. These tariff rate quotas are very restrictive for Egyptian exporters. For example, fresh grapes enter the European market duty-free during the period 2 February to 14 July, after which they are subject to a 10 percent rate of duty during 15-25 July and 15 percent thereafter. According to one grape exporter, this effectively shuts the door after mid-July. Similarly cut flowers exported to Europe pay no tariff until a quota of 3000 tons is reached, after which they pay 7-8 percent duty. Similarly, exports of fine green beans are increasing nicely, but the window into the European market is only from 15 November to 15 January. The same was true of strawberries, but it appears that this window is being enlarged from 1 October to 31 March under the terms of the new Association Agreement. These tariff rate quotas are to be reviewed within three years of the Agreement coming into force. It is essential that Egypt obtain additional concessions in this area in compensation for its opening its industrial market to European exports.

One of the advantages of horticulture is that it is relatively high valued in relation to other agricultural activities, which is especially important given the scarcity of land and water resources in Egypt (DAI 2002, Vol. II, 77). Aside from the free water that horticulture receives through its access to free water, at least on the old lands, this subsector does not receive any other government subsidy. Furthermore, horticulture does not use nearly as much water as do other crops such as rice. Capital can be invested, moreover, to economize even further on water use, for example by using drip irrigation.

Probably the most important problem faced today by the horticultural sector is the cost and unreliability of air transport services. Flowers must be shipped by air, and up to 50 percent of grape and strawberry shipments are by air. This is critical to taking advantage of the very short window of opportunity in the European market. Yet air transport is both costly and very unreliable. Much of the problem is due to Egypt Air's control over air transport. For example, Egypt Air sets minimum freight rates, which are substantially above both costs and rates of major competitors such as Kenya. Egypt Air also cancels trips unexpectedly and establishes rules, through its close relationship with the airport authority, that make it difficult for cargo planes to take over part of the business. Egypt Air also requires payment in U.S. dollars, which are hard to access without going to the parallel market. Lack of competition in cargo handling also raises costs (World Bank 2001, 40).

Another problem in horticulture is the time required for extensive testing of seeds and chemicals before they can be used in Egypt. This is particularly critical in such areas as the cut flower industry, in which rapid response to changing market conditions is essential. In addition, the cost of registering chemicals is high in relation to the volume of activity. Registration of new plant varieties takes three years.

The devaluation of the Egyptian pound had the effect of increasing profits and increasing exports. However, the exchange rate system is a problem. For example, exports of horticultural products are often made on consignment, with no assurance that a profit will be made. But even if the firm experiences a loss, it still has to convert 75 percent of its net export earnings (gross earnings minus the cost of imported inputs) into local currency at the bank rate of exchange.

Table A4-1
Exports and EU Tariff Rate Quotas for Selected Fresh Fruits and Vegetables

HS Code	Description	Exports			EU Tariff Rate Quotas
		2002 (US$ million)	Change 1998–2002 % p.a.)	Change 1998–2002 relative to world (%)	
070190	Potatoes, fresh or chilled nes	34.04	0	2	new potatoes 1/1-31/3, -100% 250,000 mt
070200	Tomatoes, fresh or chilled	1.43	-8	-11	1/11-31/3, -100%
0703	Onions, garlic and leeks, fresh or chilled	22.91	10	8	1/2-15/6, -100% 15,000 mt/3,000 mt, -60%/50%
070820	Beans, shelled or unshelled, fresh or chilled	16.54	0	-1	1/11-30/4, -100% 20,000 mt
0709	Other vegetables, fresh or chilled	5.52	30	25	asparagus 1/10-28/2, sweet peppers 1/11-30/4, other 1/11-28/2, -100%
0710	Frozen vegetables	12.19	6	3	-100% 3000 mt
0712	Dried vegetables	15.22	-4	-3	-100% 16,000
0713	Dried vegetables, shelled	13.27	5	1	-100%
071420	Sweet potatoes, fresh or dried	2.39	16	8	-100% 3000 mt
080510	Oranges, fresh or dried	65.61	7	5	-100% 60,000 mt, -60%
080610	Grapes, fresh	14.26	35	28	1/2-14/7, -100%
081010	Strawberries, fresh	8.60	46	48	1/10-31/3, -100% 1500 mt

SOURCE: Trade Map data, EU-Egypt Association Agreement

There is very little government support for research and extension related to horticultural crops. Most assistance comes from NGOs or the donors. An important element in the success of horticultural exports has been the creation of the Horticultural Export Improvement Association (HEIA) to provide support services to the industry, such as technology transfer training, quality inspection services and training, and lobbying. The HEIA has helped to secure government approval for a new cold storage facility at the Cairo International Airport, to enhance the availability of refrigerated containers for sea transport, and to push through improvements in seed and agricultural chemical policies and regulations (DAI 2002, Vol. II, 76). Another area in which the HEIA could be helpful is in promoting market development for Egyptian products in the Gulf, Eastern Europe, Asia, and Africa. This will be necessary to offset the market saturation problem cited earlier. It could be done in collaboration with the Egyptian Export Promotion Centre (EEPC). In

addition, extension of cultivation to Upper Egypt would advance the growing season during the period in which Egypt has a window of opportunity in the European market. Finally, greater processing of fresh fruits and vegetables would help to reduce the marketing constraint. An example is recent success in exporting frozen potato (DAI 2002, Vol. II, 90).

A major issue in horticulture is how to maintain timing and quality control and, at the same time, ensure that small farmers are able to participate in the growth of exports. As noted above, most of the non-traditional exports are grown on large farms where timing and quality control can be assured. Larger growers are also more likely to have the financial capacity and entrepreneurial spirit to invest in such a capital-intensive and high-risk venture (DAI 2002, Vol. II, 76). Traditional crops, on the other hand, are grown on dispersed small farms oriented towards the domestic market where these requirements are much less stringent. It is estimated that in 1998, of the total of 13 million feddan harvested, about 20 percent was in horticultural crops. To channel a large part of this production into the export market will require a well organized system of packing houses, traders, transporters, and exporters. It will also require an extensive infrastructure of good roads, refrigerated trucks and containers, well-functioning port and airport facilities, and reliable and low-cost air and maritime transportation. Much of this infrastructure is currently either lacking or in a poor state of repair.

Transportation costs tend to be high because of poor roads and high costs of maintaining and operating a truck fleet that is quite old. Renewal of that fleet is discouraged by the 40 percent customs duty on truck imports compared with a 20 percent tariff on spare parts, plus the 10 percent sales tax.[31] Even with good transportation, it would be difficult to maintain sanitary and phytosanitary standards under these highly dispersed conditions, and even more difficult to satisfy the Euro-Retailer Produce Working Group Good Agricultural Practices (EUREPGAP) standards, which are increasingly being required. Leading European buyers, in fact, increasingly obtain their imports from a limited number of large, highly qualified exporters. The HEIA and the Agricultural Commodities Council have been helping firms to gain EUREPGAP certification.

A2. Processed Foods

Egypt's processed food industry generated about $77 million worth of exports in 2002.[32] Particularly striking was the exports of vegetable, fruit, and nut preparations, which grew at an annual rate of 12 percent. A few of these products are shown in Table 4-2, which indicates rapid growth rates for vegetable preparations, jams and jellies, fruit and vegetable juices, and coffee preparations. Although the quantities involved are not very great, the

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[31] Bear in mind that truck fuel costs are highly subsidized.

[32] This industry is defined here to include Cocoa and Cocoa preparations (HS18); Cereal, Flour, Starch, and Milk Preparations (HS19); Vegetable, Fruit, Nut, etc. Preparations (HS20); and Miscellaneous Edible Preparations (HS21). This leaves aside sugar and its by-products and drinks.

rapid growth of these exports in relation to those of the rest of the world suggest that Egypt has a comparative advantage in this area. This is confirmed by interviews with exporters of these products, who stated that the subsector responded very well to the devaluation in 2003, a year after the period over which high rates of growth were already registered.

The table also shows some of the concessions being granted by the EU in its agreement with Egypt. For example, jams and jellies, as well as fruit and vegetable juices, are exempt from duty up to a quota of 1000 tons, after which they pay a duty ranging from 12.5 percent up to 24 percent plus, in many cases, a specific duty of anywhere from €4.2 to €23 per 100 kg net. Other products pay duty in a somewhat lower range without the benefit of any exemptions.

Egypt's comparative advantage in processed foods, especially of horticultural products, is based to a large extent on its long growing season and the possibility of cultivating two or three crops per year. However, there are very restrictive regulations regarding the introduction of varieties particularly appropriate for processing and long periods during which they must be tested. The result is lack of product development, lower processing yield, higher cost, and sometimes poorer quality (DAI 2002, Vol. II, 100).

As with fresh horticultural crops, Egypt is hampered by high transport cost—both internally from farm to processor and externally by sea. Egypt does have an advantage exporting to Gulf states, where the average 12 percent MFN tariff is not charged to products being imported from Egypt.

Quality continues to be the single most important constraint on growth in the processed foods industry. This is largely because high quality was not required until recently in the domestic market, which was highly protected. Exports face rigid food safety standards as HACCP (Hazard Analysis at Critical Control Points) and ISO 9000 series certification are minimum requirements to enter export markets. In addition, EUREGAP is increasingly demanding Good Agricultural Practices on the farm and Good Manufacturing Practices in the factory. Many processors will be unable to comply without very large investments. Furthermore, the need to limit pesticides to permissible levels, to control for the quality of water used in irrigation, and to prevent micro bacteriological contamination pose major hurdles for small contract farmers. Other problems are linked to poor packaging and presentation and to lack of good marketing and sales strategies. Finance can also be a serious constraint (DAI 2002, Vol. II, 100-01).

In interviews with the industry, the major problem cited was the multiplicity of government departments that issue decrees and claim responsibility over this sector. These include the Ministry of Health, the Ministry of Industry, the Ministry of Agriculture, GOIEC, and others. For example, GOIEC is responsible for seeing that traded products meet specifications, but the Ministry of Health gets involved with this as well. Often the specifications required are not in conformity with international standards. Nutritional content is dictated rather than left to the consumer through labeling. Serious delays have been encountered over very petty rules established by the Ministry of Health over labeling. The importation of equipment has to be approved by the Ministry of Health and this can

take weeks. There is no unified food law, and food certification is very risky given almost complete lack of transparency. There is an enormous need to assign responsibility for food safety to a single body and to spell out clearly what the rules are.

The industry is very critical of delays in Customs and the failure of the duty drawback scheme to function effectively. Three week delays in clearing spare parts are not uncommon, temporary admission is very complicated, and receiving duty drawback payment can take one and one-half years. There are no investment incentives outside the special development zones.

A3. Poultry

The poultry industry is the one industry in which Egypt is not now in compliance with its WTO commitments. In particular, there is a ban on imports of poultry offals and limbs, and the import duty on poultry is 80 percent. As a result of this very high tariff, Egypt only imported $1.2 million of poultry in 2002, though imports rose very rapidly over the period 1998-2002. About three-quarters of these imports were from Brazil, with most of the rest being supplied by the United States. This rapid growth may be a reflection of the overall growth in demand for broilers, which has been rising at about 9,6 percent per year since 1990. In contrast, table egg production has remained relatively stagnant (DAI 2002, Vol. II, 128-29).

The poultry industry in Egypt operates at several different levels. At one level is a commercialized, industrialized, high-technology poultry system, which produced 73 percent of all broilers and table eggs in 2000. About 6 percent of these farms are larger than 20,000 head and account for 21 percent of broiler capacity. These farms are linked to modern processing plants and operate quite efficiently. Smaller farms, however, tend to have lower feed conversion rates, higher mortality levels, lower live-weight, and lower levels of capacity utilization. About 30 percent of these were forced to close after the government eliminated feed and credit subsidies. Finally, there is local village production, some of which reaches local markets. In Egypt, most marketed poultry from these last two sources is slaughtered by local butchers rather than in processing plants, which deliver refrigerated or frozen meat to retail shops and super markets. This is because of consumer preferences to buy live birds and because transportation costs to processing plants are high (DAI 2002, Vol. II, 129-30).

Poultry feed mills process imported yellow maize and soybeans as their primary inputs. Most of these mills are privately owned and operated. Capacity utilization has tended to decline because the larger integrated farms now do much of their own feed mixing to ensure quality and reduce costs. Thus the mills sell feed primarily to medium and small farmers. Because the government used to subsidize feed and feed ingredients, and to enforce low prices for these feeds as well as control access by the mills to imported ingredients, the feed mills were operated quite inefficiently. With the removal of these subsidies, a more efficient feed industry has begun to emerge (DAI 2002, Vol. II, 132).

The major problem for Egyptian producers, as for many poultry producers throughout the world, is that of a joint product—chicken breast and chicken limbs. The first is sold for a substantial premium in the markets of the industrial countries, so the second can be sold at very low prices on the world market. Within Egypt, on the other hand, the two products sell for very nearly the same price. Egypt has a very difficult time competing with low-priced imported chicken limbs, and thus the ban. This is especially important vis-à-vis U.S. producers, who are very efficient and sell chicken parts on the world market at very low prices, recovering their costs in the high-priced domestic market for chicken breasts. This needs to be taken into account in the event that a FTA is signed with the United States.

Over the longer term, the efficient portion of the broiler industry in Egypt should be able to process a larger proportion of its output in the form of cold cuts, chicken nuggets, and other prepared products, which use a larger proportion of white meat, thus enabling them to sell dark meat more competitively. According to a number of producers in the industry, these processed products could be exported profitably to Europe. The only constraint has been the failure of the Ministry of Agriculture to obtain the registration required, despite a request by the industry going back to 2002. However, expansion into this market will require better access to the European market than exists at present. In the meantime, a fairly large amount of protection will be required if the industry is to survive. To meet WTO commitments, however, this protection should be temporary and in the form of safeguards against surges of imports rather than outright bans and very high import duties. In addition, the possibility of dumping by the industrial countries should be investigated since prices of dark meat in Egypt appear to be lower, when expressed in U.S. dollars, than those in the United States.

A4. Cotton

The cotton sector in Egypt employs two to three million small farmers plus thousands of others involved in its transport, processing, marketing, and exportation. Cotton is grown mostly in the Delta and Middle Egypt as a summer crop along with maize, rice, and fruits and vegetables. This complements wheat, beans, and berseem, which are grown on much of the same land in the winter. The cotton that is cultivated is made up predominately of long-staple (LS) and extra long-staple (ELS) varieties, in which Egypt has a substantial comparative advantage due to its ideal soils and climate (DAI 2002, Vol. II, 57-58). Egypt currently produces LS and ELS cotton almost exclusively.

The total area planted to cotton has declined over the years from 1.2 million feddans (0.5 million hectares) in 1980-81 to 750,000 feddans in 2001-02 (DAI 2002, Vol. II, 59). This has been due to a number of factors, including comparatively low prices for long and extra long-staple cotton on the world market, competition from other crops such as rice, and major policy and marketing distortions.

At the farm level, until the early 1990s, farmers were not free to choose what crops they should grow. Since the Economic Reform and Structural Adjustment Programs of that

period, farmers have had greater freedom, but if they choose to grow cotton, they must adhere to the government's varietal recommendations. Furthermore, although farmgate prices have not been controlled by the government since 1995-96, a system of floor prices has been established for the private sector at levels that are relatively arbitrary and do not change over the course of the season. Furthermore, the price paid by the public sector is also fixed and does not vary seasonally. These prices are determined more by levels of carry-over stocks held by the state and the needs of the largely state-owned spinning industry than by world market prices. In addition, overpricing by Egypt has allowed new entrants into the market for Extra Fine (LS and VLS) cotton, such as the United States, with its American Pima. One result is that Egypt lost some of its world market share and its role of price leader in the LS and ELS cotton market (DAI 2002, Vol. II, 60). Today about one-half of total world production of Extra Fine cotton takes place in Egypt.

Until the mid-1990s, government trading companies dominated ginning and marketing of cotton. With relaxation of controls in 1995-96, the private sector increased its share of marketing from 3 percent to 25 percent. However, when the floor price of cotton was later raised above the world market price in 1999-2000, private trading companies withdrew from the market and the public trading companies were obliged to purchase all the cotton on the government's behalf. The Alexandria Cotton Exporters Association (ALCOTEXA), which controls the exportation of all cotton lint, set a minimum export price as high as it thought feasible, but this discouraged foreign purchases and led to a large increase in carry-over stock. Spinning mills were under pressure to buy this cotton at prices substantially above the cost of importing short and medium-staple cotton, which would have satisfied their needs. This is but one example of how setting fixed or floor prices and assuming responsibility for unsold inventories has resulted in serious distortions in the market and led to the accumulation of large and deteriorating stocks of unsold cotton. This, in turn, has resulted in efforts to manipulate planting decisions, which has contributed to a serious decline in cotton production (DAI 2002, Vol. II, 67-68).

Despite these disincentives, devaluation of the Egyptian pound resulted in an increase in prices measured in terms of local currency, which provided the incentive needed to increase exports and reduce inventories of both cotton and cotton yarn. Thus the rate of growth of Egyptian cotton exports from 1998 to 2002 was 1 percent in comparison with growth of cotton exports worldwide of -6 percent.[33] However, this is a temporary trend, which is unlikely to be repeated once the pound has reached a reasonably stable level. The broader trend of exports has been downward, and this is unlikely to be reversed by any of the trade agreements to which Egypt is a signatory since Egyptian cotton enters most markets duty free.

Another important market distortion that has discouraged cotton production has been the incentives offered to rice cultivation. Rice production grew by 4.7 percent per year during the 1990s, largely because of favorable market prices. However, by 2001, rice mills found it

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[33] See Table 2-2.

increasingly difficult to export to the world market, where prices had fallen significantly. The government then announced export subsidies of up to $50/ton to facilitate rice exports (DAI 2002, Vol. II, 53-55). Despite this, rice exports declined by 8 percent annually from 1998 to 2002 (Trade Map data). In addition to the export subsidy, rice also benefits enormously from the availability of water free of charge, especially because rice is a crop that uses water very intensively. If water were priced at its relatively high scarcity value in Egypt, rice production would not be profitable.

Aside from the supply-side constraints, Egypt also faces the problem that the price premium for LS and VLS cotton has declined somewhat on the world market because of improvements in spinning technology and the availability of synthetics. The main factor behind the declining demand for this cotton, however, has been the shift in consumer preferences towards casual wear. This trend appears to be reversing, and there are signs of increasing consumption of fine cottons in the United States and possibly in Europe.

The potential for Egypt's expanding its production and exports of high quality cotton is considerable. "According to the field trials of the Egyptian Cotton Research Institute, the yield potential of some Egyptian varieties is above 12 kentar per feddan, while the average harvested is about 7 kentar per feddan….Breeding and research in Egypt is burdened by the conflicting goals of producing the finest cotton in the world for the export market or producing ordinary and cheap cotton for the domestic Egyptian market" (World Bank 2001, 27-28). Other improvements in seed utilization, crop husbandry, and integrated pest management would have high payoffs (DAI 2002, Vol. II, 63).

On the other hand, some have argued for the introduction of shorter-staple upland cotton varieties in order to expand the marketing horizon of the cotton industry, cater more to the needs of spinners and weavers producing for the low-end domestic textile and clothing market, and free up longer-staple cotton for higher-valued yarn, cloth, and garments. The government has accepted this in principle, especially on the newly claimed lands

As a member of WTO and a major cotton exporter, Egypt would benefit very much from a reduction of the subsidies being offered to cotton farmers in the United States. This has been the subject of a sectoral initiative submitted to the WTO by four West African countries and the filing of a formal dispute settlement claim by Brazil. In the longer run, the best chance for resolution of this problem probably lies with progress on the Doha Round of WTO trade negotiations, but these seem to be at least temporarily stalled after the meeting of ministers in late 2003 in Cancun. Egypt would do well, however, to have the issue of cotton subsidies on the table for any negotiations with the United States on an Egypt-US FTA.

A5. Textiles and Garments

A. OVERVIEW AND GLOBAL TRENDS

The textile and apparel sector, with exports amounting to $801million in 2002, was second to petroleum in importance among goods exports. The government considers textiles and apparel to be a priority sector because of its potential for expansion, not only in terms of current employment and export strength, but also because of its potential for regenerating Egypt's export dynamism under the *Egyptian Cotton* label.

Egypt's cotton textile-garment industry has two subsectors that have very different characteristics and require different policies. Fine, high quality, light-weight, tightly woven, soft-to-the-touch fabric is made from the long and extra long-staple cotton grown in Egypt. Most of these fabrics and garments made from them are exported. They are designer or quality branded shirts, blouses, and bed linens. In the world marketplace, quality-made garments from fine Egyptian cotton are the best that money can buy followed by slightly inferior Pima cotton from the United States and Indian cotton that is inferior to Pima. Consumers pay a high price for the products of Egyptian cotton, providing manufacturers with good margins.

In addition to growing some of the best cotton in the world, Egypt could establish itself in a unique niche of the market and be the high-quality cotton garment manufacturer in the world. But it needs a clear strategy and has to be dedicated to implementing the strategy. The high quality and positive qualities of Egypt's fine, long and extra long-staple cotton have to be apparent in the final garment. Thus every step through the processing chain has to be done with high quality and fine/delicate/special in mind.

The other subsector that is important in Egypt is medium-grade apparel made from imported cotton or wool, yarn, and fabrics. These materials are knitted or woven into courser fabric for casual wear, sportswear, underwear, etc., which is sold domestically or exported. The prices are relatively low, the margins are low, and global competition is high. In some cases, Extra Fine Egyptian cotton is used to produce garments for this market, which is not the best use of this valuable raw material. This subsector has been protected by high tariffs that were reduced in January 2004, and will be reduced further under Egypt's free trade agreements.

The most important external change that affects this industry, especially the mid-quality subsector, is the ending of the Agreement on Textiles and Clothing (ATC) quota system at the end of this year. Starting January 2005, Egypt's textile and garment exports will compete head-to-head with powerful exporters such as China and India, which have been expanding aggressively over the last decade or so. The implications of this major event in world markets are discussed below, along with specific strategies that could minimize adverse effects. Unlike most other export and import competing sectors, textiles and garments face the ending of the ATC in addition to more generic trade liberalization measures based on WTO commitments.

A long-term trend that is important for export success is the development of globally extended value chains of production. These vertically integrated production chains have evolved to minimize costs over the entire value chain while enhancing product quality and bringing the latest designs to the biggest markets in the shortest space of time. Global competitiveness is based on fitting into these value chains in the most efficient manner possible. To survive in the long-run, Egypt's producers must use new technologies very close to best practice and acquire immediate access to the global information networks which supply up-to-date market information. Clearly some of the presently successful exporters are well positioned in this respect, but many are not and do not realize the danger they face from the ending of the ATC and further liberalization of domestic trade barriers.

B. RECENT EXPORT AND IMPORT TRENDS

Total textile and clothing exports—in categories HS (Rev 1) 50 through 63—were around $1.25 billion in 2002, down slightly from the 2001 figure of $1.3 billion.[34] The 2002 figure is approximately 22 percent of total exports of merchandise from Egypt, which had risen 13 percent from the 2001 figure. In both absolute and relative terms, it is clear that textile exports have already declined somewhat in the face of intense competition from Asian producers. Of 2002 exports in these categories, 42 percent was imported by the United States, 39 percent by the European Union, and 13.3 percent by Asia. About 70 percent of Asia's imports were cotton and cotton yarn in the HS 52 category.

The pattern of exports to the United States and EU markets is shown in Figure A5-1. Though these markets are approximately the same size in value terms, 74 percent of U.S. imports consist of apparel compared to only 52 percent for the EU. The EU takes much more yarn and other categories. The proportion of home textiles taken is similar. While exports to the EU are more diversified, the United States attracts higher value apparel. Being concentrated in a relatively narrow range of products, however, exports to the United States are more vulnerable to competition when quotas are eliminated in 2005. It has been estimated that 84 percent of Egypt's exports are in categories that will face increased competition from this source.

If only cotton-based exports are considered, the aggregate export value drops to $1.05 billion. A detailed breakdown of export and import trends for cotton-based categories is given in the text in Table 4-2. The value of imports in these sectors is just under 17 percent of export value, on account of the high degree of protection and because much of the inputs used in production are obtained locally. However, many producers complain of a high level of smuggled apparel items from Asia, so the figures understate the real extent of imports.

The best performer in the export area is knitted or crotched men's suits which have grown by 50 percent per year over the last four years. Women's suits and other clothing items and tufted carpets have also grown at high rates. Men's shirts of all kinds have declined sharply

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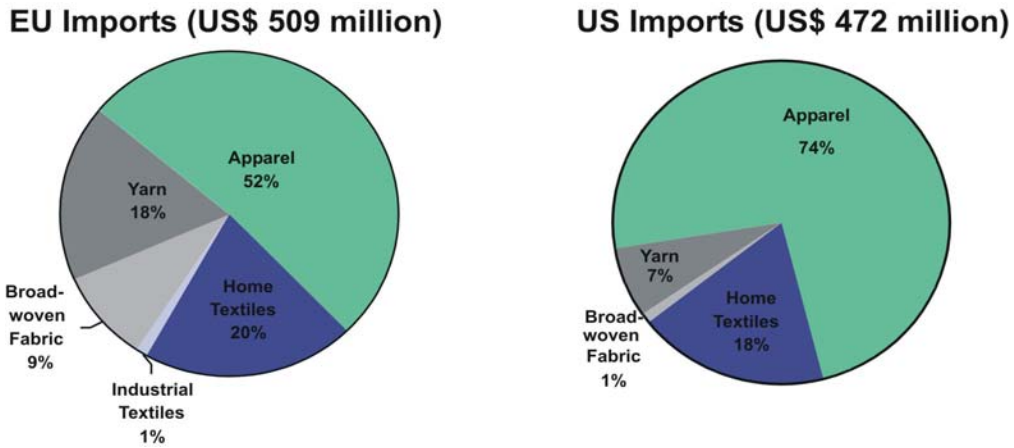
[34] Includes products made from silk, wool, and manmade fibers other than cotton.

and their present export volumes are small. Of special concern are the decline of cotton yarn and woven fabric exports over the 1998-2002 period, which indicate falling competitiveness in cotton spinning and weaving industries. Import values are also down in most cases, probably on account of currency depreciation.

Figure A5-1



EU and U.S. Imports of Textiles and Apparel from Egypt, 2002

SOURCE: EuroStat and OTEXA data. Compiled by Peter Minor and Egyptian Ministry of Foreign Trade personnel.

C. REDUCTION OF DOMESTIC TRADE PROTECTION

Egypt lifted a ban on fabric imports in 1998 and a ban on apparel imports in January 2002 in accordance with WTO commitments. Tariffs have been high, however, with specific duties on over 1000 categories of garments ranging up to $300 per item. This was in violation of Egypt's WTO tariff bindings.

On January 21, 2004 a Presidential decree was announced in which protection levels were to be brought down to 40 percent for most ready made clothes, with specific duties converted to ad valorem rates. Duties on imported fabrics were to be reduced from 54 percent to 22 percent and those on yarn and raw cotton were to be set at 12 percent and 5 percent respectively. Home textiles were to enjoy a 35 percent level of nominal protection while machinery for the textile industry and dyestuffs were to be exempt from customs duties altogether. Details of Egypt's current tariffs, assuming implementation of the January 21, 2004 decree, and future commitments are show in the text in Table 5-1.

D. TEXTILE AND GARMENT INDUSTRIES: STRENGTHS AND WEAKNESSES

Cotton

Land used for cotton production has declined over the past decade, with 450,000 feddans planted in 2003 compared to about 900,00 feddans in 1996-97. The production of long-staple (LS) and extra long-staple (ELS) cotton had also reached record low levels over the last decade, but may now be recovering slowly. This seems to have resulted from liberalization of the domestic cotton trade in 1994 when the state gave up monopoly control over cotton production and compulsory cultivation was stopped. As some farmers shifted out of cotton production, local prices went up at the same time that world prices were falling. Some marginal yarn and fabric producers were pushed out of business, and the government experienced substantial losses on the cotton it held in storage. At the same time Egypt was flooded with cheap textiles from China, Pakistan, and other Asian countries (Ibrahim and Ibrahim, 2003; p.171). However, higher prices and concerted efforts by the government to expand cotton production to 750,000 feddans in 2004 may reverse this trend.

Domestic consumption of products made from LS and ELS cotton is declining rapidly as a result of increased use of synthetics in Egyptian fabrics along with cotton yarn and fabric imported from Asia. The boom in exports of ready-made garments has not benefited domestic cotton producers or spinning mills since these exports use mainly imported yarn and fabrics brought in duty-free into free trade zones or establishments under "temporary admission."

One highly successful exporter of ready-made garments argues that Egypt needs a "national cotton policy" to resolve problems of cotton supply. He believes that more short staple cotton needs to be produced locally since there is not a strong demand for LS and ELS fibers for the domestic market. Because of shortages of local cotton, Egyptian spinners are now importing cotton from Greece, Syria, and Sudan. This ignores, however, the strong demand on the world market for LS and ELS Egyptian cotton, the price of which is almost double the price of short-staple cotton. For example, after devaluation in 2003 raised the price of cotton yarn to Egyptian spinners, exports to the United States increased from 1,276 tons in 2002 to 3,457 tons in 2003. This volume cannot be sustained, because much of the expansion took place through the sale of yarn already held in stock, but it illustrates the strong demand that exists.

Spinning

Two systems for cotton spinning are currently in use.

- The ring system is more suitable for LS cotton. It can produce very fine yarn as well as thicker yarn depending on how the machine is set. To spin very fine yarn, the cotton must be free of impurities and properly prepared. The speed of the machine is then set lower than for medium yarn. In producing thin yarn, low breakage and maintaining the regularity of the thickness are critical. It is more difficult to produce fine, thin yarn and employees need special training.

- The open-end system is better for producing medium thickness yarn. Egypt does not have many of these machines.

There are five or six private spinning companies and approximately 20 large, government-owned spinning enterprises. The private companies are more efficient than the government companies. It is not a question of machinery. Perhaps 30 percent of the machines are older and need to be upgraded, but the rest are fine. The main reasons for inefficiency are lack of training of employees with the resulting drop in quality, the use of too many employees adding to product cost, and the choice made to produce medium grade cotton yarn, which fetches a lower price in the marketplace. Many Egyptian textile mills are also uncompetitive because of burdensome debt. As a result, some mills are operating at capacity levels approaching 10 percent or less. These mills are now under pressure to use cheaper inputs, regardless of location and long-standing relationships with local farmers. The result is growing cotton imports.

There is an opinion in some quarters (Dr. Allesandro Cerrettini, IPI Italy) that Egypt cannot be competitive in highly capital intensive spinning and weaving operations. Labor costs in spinning are around 5-10 percent and in weaving around 45 percent of the total. This view is contradicted by existing viable operations and also by other experts. Furthermore, it ignores productivity gains that can be achieved by better industrial engineering practices. Studies indicate that technical efficiency in such operations in developing countries can be improved vastly with some assistance from specialist consultants. This argument is buttressed by the fact that a Korean company is currently leasing a public spinning mill and operating it reasonably efficiently.

Weaving

The weaving companies are split roughly 50-50 (???) between the private and public sectors. There are not so many problems in this subsector. For highest quality textiles, synthetic yarns should not be used because the benefit of softness is lost. The benefit of "wrinkle resistance" that synthetics provide can be achieved by proper finishing of highest quality cotton fabric and it is easy to do.

Knitted fabrics

Companies that knit fabrics usually also make apparel. This subsector works reasonably well.

Dyeing and Finishing

By common consensus, dyeing and finishing are the weakest areas in the domestic production chain, because they are very specialized fields in which technology and technical standards are constantly changing. The main requirement is that the chemicals used in dyeing and finishing processes must impart no toxicity to fabrics used for garments and home furnishings. Also, the processes must be sustainable in the sense that the effluent cannot adversely affect the environment. Chemicals used in dyeing and finishing affect

fabric characteristics and the current trend in all major markets is to use chemicals that are less toxic, less polluting, and so on. There is now a high degree of consumer awareness in the European Union in particular as a result of press reports of incidents involving toxicity,

According to Karl Borgschulze, Head Consultant for Printing, Weaving, Knitting, and Dyeing of the Otto Group, in the EU there are more than 7,000 chemicals available. Researchers in the major chemical companies are continuously developing chemicals with new characteristics to be used with certain types of yarns. Most developing countries, including Egypt, use only 10 percent of the chemicals that are available. This limits Egypt's ability to produce the advanced types of fabrics that the EU and U.S. markets demand.

In publicly held companies, production processes are integrated vertically. There is added complexity of combining chemicals in an integrated process. Many private companies also dye and finish fabric in-house, although some dye yarn that is then woven into fabric, e.g. to be used in men's striped dress shirts. The problem in this subsector is not the quality or age of the machines used, but the knowledge and skill levels of employees who are not up-to-date regarding dyeing and finishing requirements demanded by the international marketplace. Their knowledge of state-of-the art chemicals and processes is limited. The manufacturing quality standards are also too low. For example, they might use chemicals that have a relatively high level of impurities or whose "use-by date" has passed.

Manufacturing Apparel and Household Textiles and Carpets

The Egyptian ready-made garments and household textiles and carpets industry is relatively new. This industry targets the local market with Egyptian textiles made of both Egyptian and imported yarns, and the international market using mostly imported yarns and fabrics. In 2002, the subsector exported $826 million worth of merchandise, mostly in the higher quality woven and knitted clothing range, where Egyptian exports are considered to be quite competitive.

There are well over 500 manufacturers of garments, virtually all of which are private. Of the 12 publicly owned clothing factories, the largest is El-Nasr Clothing and Textile Company (Kabo), a knitwear giant that has traditionally specialized in underwear, night wear, and T-shirts, but which is now diversified into a wide range products for export. Two other public enterprises, as part of joint ventures with foreign firms, have extensive sales abroad. Most of the remaining public firms are selling predominantly middle and lower end garment products in the local market. This area of production has been highly protected until recently, and it remains to be seen how it well it will respond to the reduced tariffs that were recently announced.

Among the private garment producers, factory-made ready to wear has replaced the traditional dressmaker and tailor shops. The small-sized but modern factory (60–80 workers) has typically been the testing ground for private clothing manufacture, and only few of these firms have started with a big operation. The dozens who became successful have graduated to the 200–1,000 employee size. Many of those have in turn moved either to

produce international brand names under license or franchises from international companies.

A key feature of the textile and clothing industry is the extensive degree of subcontracting and outsourcing. Subcontracting and specialized services are widely available, with only a few of the large public and private firms being highly integrated. Even public enterprises in the textile industry have always relied on the subcontracted output of hundreds of medium-sized private firms.

Some major exporters have entered into arrangements with retail chains in Europe and the United States (K-Mart, Macy's, Marks & Spencer, and C&A) or opened their own retail outlets (Concrete, Mobacco, and Octopus) in Australia, Bahrain, France, Jordan, Kuwait, Libya, Saudi Arabia, and UAE. Others are producing under designer labels such as Liz Claiborne, Calvin Klein, and Perry Ellis.

The household textile and machine made carpets industry is also witnessing an export boom. Towels, bed sheets, and tablecloths are produced by numerous private and public firms, several of which have become important exporters. The largest export markets for household linen have been France, Germany, Italy, and the UK. A number of companies are also producers of machine-made carpets.

Many ready-to-wear garment manufactures are located in one of Egypt's seven free zones. This exempts them from customs duties, sales tax, and other taxes on condition that their output is exported. If it is sold domestically, then it is treated as if it were imported. In a few instances, companies in themselves are considered as free zones. The advantage of free zone status is that it greatly simplifies the process of customs clearance and avoids the delays and uncertainty associated with the duty drawback scheme.

E. LINKAGE WITH INTERNATIONAL MARKETS

U.S. Market

The U.S market for Egypt's textile and clothing exports will be affected more by the elimination of textile quotas under the ATC than the EU market. Out of total 2002 exports to the United States, 88 percent were in categories in which Asian suppliers were quota constrained (See Table A5-1). U.S. textiles and apparel quotas constrain 13 countries on average in each category, but considerable variation exists in the number of countries that are quota-constrained. For cotton trousers and knit shirts, 16 and 17 countries, respectively, are constrained, whereas only 3 cotton yarn exporters are.

Another factor influencing the impact of quota elimination is the market share of quota-constrained producers. Considering only product categories that are constrained by quotas, quota-constrained producers have, on average, one-third of the market share of U.S. imports. Again, considerable variation exists by product. Synthetic-fiber coats and trousers and cotton coats lead in categories based in the market shares of quota-constrained

importers—all approximately 50 percent of U.S. imports. In contrast, quota-constrained imports of cotton yarn represent just 9 percent of U.S. imports.

Table A5-1
U.S. Imports of Textiles and Apparel from Egypt and U.S. Quota-Constrained Suppliers 2002

Quota Category	Product	US Imports from Egypt 2002		Constrained Suppliers	
		Value (US$1,000)	Percent of Egyptian Trade	Number of Countries Constrained by Quotas [a]	Percent of US Imports Constrained by Quota
347/348	Cotton trousers	176,318	37.2	16	32.5
338/339	Cotton knit shirts	79,499	16.8	17	36.3
300/301	Cotton yarn	29,165	6.2	3	9.0
340/341	Cotton woven shirts	19,927	4.2	8	45.4
635/634	Synthetic fiber coats	19,446	4.1	12	52.2
647/648	Synthetic fiber trousers	8,930	1.9	16	47.9
334/335	Cotton coats	7,698	1.6	12	47.7
340/341	Synthetic fiber knit shirts	5,344	1.1	8	25.8
--	Other quota-constrained	70,636	14.9	23	30.0
	Subtotal constrained	416,963	88.0	13	33.2
	Unconstrained	55,952	12.0	--	--
	Total	472,926	100.0	--	--

SOURCE: U.S. Department of Commerce, Office of Textiles and Apparel. Calculations by author.

[a] A country is defined as quota-constrained if it *filled* its quota by 90 percent or more.

Figure A5-1 illustrated that three-quarters of Egypt's exports of textile and apparel products to the United States are apparel. Breaking that down further, 55 percent of Egypt's exports to the United States are in just two apparel categories—cotton trousers and cotton knit shirts. The lack of diversity presents a high risk, because these categories benefit from tight U.S. quotas constraining 16 and 17 Asian countries, respectively. One clear way Egyptian exporters could reduce the impacts of quota elimination is to diversify into products for which quotas are not currently an important determinant of market access. Egyptian exports not facing increased competition from quota elimination include synthetic and wool carpets[35] and babies' garments.

EU Market

The European Union market is clearly Egypt's most important export market for textiles and garments. A previous Nathan Associates report estimates that 81 percent of product categories will be affected by the elimination of EU quotas, as shown in Table A5-2.

[35] Egyptian producers revealed in interviews that they fill a niche market for specialty rugs using propriety production techniques and design capabilities that are only recently being replicated by Asian producers.

However, Egypt's exports to the EU are much more diversified among product lines than are those to the United States, which should put Egypt in a stronger competitive position.

Table A5-2
EU Imports of Textiles and Apparel from Egypt and Quota-constrained Suppliers 2002

Quota Category	Product	EU Imports from Egypt		Quota-constrained Suppliers[a]	
		Value (Euros 1,000)	Percent of Egyptian Trade	No. of Countries Quota-constrained	Percent of EU Imports from Constrained Suppliers
4	T-shirts lightweight fine knit roll polo or turtle necked jumpers and pullovers	88,190	16.7	4	16.2
1	Cotton yarn not put up for retail sale	83,837	15.9	2	23.2
13	Men's or boys' underpants and briefs cotton or MMF Knit	52,452	9.9	2	28.6
9	Terry toweling and similar woven terry fabrics of cotton; toilet linen	24,707	4.7	2	21.7
6	Cotton and MMF trousers and shorts	24,697	4.7	12	21.7
20	Bed linen other than knit	22,965	4.3	2	39.4
39	Table linen other than knit or Terry	22,724	4.3	1	39.4
2	Woven fabrics of cotton other than gauze terry fabrics pile fabrics	19,597	3.7	2	16.6
68	Babies' garments and clothing accessories other than knit [c]	15,123	2.9	1	0.7
35	Woven Fabrics of Synthetic Fibers	13,483	2.6	2	10.8
Other	All other constrained [b]	59,960	11.4	11	24.2
	Subtotal quota-constrained	427,735	81.0	4	22.6
	Unconstrained	81,270	19.0	N\A	N\A
	Total	509,005			

SOURCE: Europa statistics for quota fill rates. Trade data from EuroStat. Calculations by author.

[a] A country is defined as quota-constrained if it filled its quota by 90 percent or more.

[b] Number of countries quota-constrained represents the largest single number of countries quota-constrained for a category in which Egypt exports.

[c] Under the ATC, baby garments were integrated in earlier years, current quotas are against non-WTO Members.

F. CONCLUSIONS

Enhancing Competitiveness

A strong feature of Egypt's textile and garment industry is its potential for vertical integration. It has capability at all stages. Even though some stages, such as dying and finishing, are weaker than others, these can be upgraded at relatively low cost. Furthermore, Egypt has the advantage of working with the very best cotton for which an image on the world market has already been established. What is needed is working together to carry through this market-driven vision. This will require improvements in

some of the processes; better management, marketing, administrative, and accounting skills; and improved use of information technology. There is a good technical, know-how base but it needs to be updated. The situation is much better than in some of Egypt's competitors, such as Tunisia or Morocco, which do not have all stages of the production sequence within the country.

On the negative side, as a result of high levels of protection, Egypt has developed serious weaknesses in some areas, which need to be addressed immediately if it is to realize its potential. By all accounts, the greatest weaknesses lie in the dyeing and finishing operations; Egypt quickly needs to upgrade technology and practices in these areas.

While the garment sector is thriving, spinning and weaving operations are also not competitive by international standards. It is clear that there are substantial production inefficiencies that have built up over many years and gross over-manning, especially in public sector operations. The positive experience with the Korean company which has turned around a leased government operation, without reducing the workforce, indicates that there is considerable room for productivity gains through improved management practices. These need to be supplemented through capital investments in state-of-the art technology and, eventually, a reduction of the labor force, through retirement or other measures that do not impose too much of a cost on workers. Publicly owned enterprises have severe constraints in raising capital for new investments, so a complete solution may not be possible without full privatization.

Spinning operations have survived only because of controlled low prices for cotton, which have adversely affected the growing of cotton. Hence reform and regeneration of spinning and weaving industries would permit Egypt to engage in these activities while buying its cotton at internationally competitive prices. This should induce farmers to grow more of the better quality varieties. If the markets for all kinds of cotton were liberalized, then lower-priced short and medium-staple cotton used in fabric and garments for the domestic market could be imported, while higher quality home-grown varieties would be used in higher quality fabrics and also exported at competitive prices. Clearly, the liberalization of markets in all stages of textile and garment manufacture needs to be integrated with technological renewal and productivity upgrading in spinning, weaving, dyeing, and finishing operations.

International Market Access Issues

The termination of the ATC at the end of this 2004 will generate major challenges for Egypt's garment exports. China will be a big competitor in 2005, targeting the mid and lower-end markets. Egypt will not be able to compete against China and other Asian producers in the EU or the United States if it faces the same tariffs. Egypt should, of course, maintain manufacturing in the mid and low-end markets to supply domestic consumption and exports within other regional trading groups.

A previous report (Minor 2004) has estimated that with the ending of the ATC, employment in Egypt's textile and apparel industries will fall by 22,185 direct jobs, and total exports will decline by US$203.9 million. This represents a 19 percent fall from the 2002 value of textile and apparel exports. Losses in the U.S. market are estimated at $136.5 million, along with the loss of 14,858 direct jobs, which is two-thirds of total projected losses. In the EU market, Egypt is estimated to lose $67.3 million in exports and 7,327 direct jobs. The biggest losses are anticipated for apparel exports with some lines falling by 50 percent or more.

The above loss of exports would be substantially avoided if Egypt were to enter into a free trade arrangement with the United States, which would give it a 17-38 percent advantage over China. On the downside, the United States has announced free trade negotiations with around a dozen countries seeking permanent duty free market access for their textile and apparel products. If these negotiations are successful, Egypt will lose some of the advantage from establishing a FTA with the United States.

Another factor of importance is that China's export strength derives partly from an undervalued currency. For many years now, the Chinese government has kept the Yuan undervalued by direct intervention. This has given rise to strong economic and external political pressures on the government to move to a more realistic exchange rate. It is unlikely that China can resist these pressures for much longer, so it is possible that very soon its export prices could rise in dollar terms.

The European Union has also been moving ahead on agreements with preferential suppliers. Furthermore, 10 countries in Eastern Europe will accede to the European Union in May 2004. Egypt currently does have preferential access to the EU, but that access is dependent on meeting rules of origin requirements. However, under the new EU-Egypt Association Agreement, Egypt can qualify by adopting diagonal cumulation strategies that integrate textile and apparel production within the Euro-Mediterranean region (see Minor, 2004 for details). It is clear that Egypt's success will depend on its ability to move forward with a global and regional trade strategy in textile and apparel products at home and abroad.

The rapidly changing trade environment will surely result in a world market that looks different than it does today. Textile and apparel buyers will be looking to reduce the number of suppliers from which they purchase apparel.[36] Large importers such as J.C. Penney and Sears currently are supplied with garments from 30–40 countries because quotas prevent them from getting enough units from a single country. Once the quotas are eliminated, they will choose to reduce this number considerably.

Buyers will seek suppliers that can provide value-added services and broad product lines. Egyptian suppliers can take the following steps to meet these challenges:

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[36] A U.S. department of commerce survey concluded U.S. buyers would reduce by one-half the number of suppliers they currently buy from soon after the elimination of quotas.

- Engage in the Doha Round of negotiations to improve market access and rules-based trade regimes.
- Negotiate free trade agreements to move ahead with regional trade integration.
- Develop a national trade and industry strategy that integrates and harmonizes the often-conflicting strategies of textile and apparel producers.
- Incorporate up-to-date information technologies in marketing and resource planning systems.
- Increase textile and dyeing capacities to meet strict rule-of-origin requirements.
- Enhance knowledge of regional fabric sources (associated with the Euro-Mediterranean rules of origin).
- Streamline customs processes to meet the challenges of new U.S. and EU antiterrorism procedures.

Egyptian producers would benefit from developing a strategy to respond to the new retail environment emphasizing low inventories and fast turnaround. The Egyptian government can assist in the formulation of a national strategy and lines of action supporting the integration of the textile and apparel industries into global value chains rather than continuing to focus on local markets and following the path of isolation, high cost, and low productivity. The goal of government policy can be to present a clear predictable framework within which workers, producers, and investors can feel confident in their undertakings. In this way, Egypt can promote long-term growth by consolidating a secure place in the global textile and apparel market.

A6. Furniture and Other Wood Products

This highly fragmented industry consisting mostly of SMEs produces revenue of $230 million per year *[check this number]* consisting of exports (13 percent) and domestic consumption (87 percent). The domestic industry is protected by a 40 percent tariff rate on imports of furniture.

TradeMap data indicate $30.5 million of exports in 2002. Statistics obtained from the Ministry of Foreign Trade (MOFT) show much lower furniture exports: $ 3.6 million in 2000 and $ 5.8 million in 2001.

HS Code	Exports		Imports		2003 Tariff Rate
	2002 (mil $US)	Change 1998-2002 % pa	2002 (mil $US)	Change 1998-2002 % pa	
9403—Other furniture and parts thereof	30.54	1%	18.72	-10%	40%

SOURCE: *ITC TradeMap*

TradeMap shows exports from Egypt to the United States in the category "furniture, lighting signs, and prefabricated buildings" to be $22 million in 2002, compared to $14.5 million to the EU and $9.4 million to the Middle East. Commodity Council representatives agree roughly with these figures. Russia was a major market for Egyptian furniture and today the Middle East is replacing it, but the focus of the export industry is still moving toward the larger U.S. and EU markets.

Industry sources said that here are no tariffs on most exports to the United States because these are classified as handicrafts. *[check this]* In some cases, an entire piece is hand-made. In others, the general shape is done by machine and the final details are worked by hand. Some Egyptian furniture with export potential would not qualify for handicraft status. Thus, a U.S. tariff reduction on imported furniture would benefit sales.

The furniture industry is an important sector of the Egyptian economy with great upside export potential. The market niche where Egypt has a competitive advantage is antique reproduction and handiwork/woodcarving. Antique reproductions is another significant handcraft subsector with export potential. Some members of the Furniture Council thought that their target market was mid-range furniture for smaller hotels and offices. A run of 500 or 1,000 pieces is possible in Egypt but is inefficient in the United States.

Furniture exporters need to know standards, regulations, and market information in target foreign markets. Certificates of International Standards would be a next step to be able to guarantee Egyptian quality for hotels and other buyers in the medium market. This is essential to selling in this market niche! Egyptian manufacturers have never produced for this category (hotel furniture) so they are not familiar with requirements. *[Get more info. on accreditation.]*

[Contact importers of Egyptian furniture in US to determine competitive advantage of Egyptian furniture and what would help increase sales in U.S. market. Ask what are the limitations that should be corrected. What is the nature of the closest competition? What would be other niches where Egyptian furniture could gain market share?]

Best product opportunities have been identified in the EU markets in the following types of furniture: ethnic-design furniture, RTA (ready-to-assemble), home office, small/occasional, and furniture for children and the elderly.

Furniture and woodworks activity is run primarily by the private sector. The statistics from the General Organization for Industrialization (GOFI) and the Industrial Registry, are inconsistent with each other saying the total number of furniture and woodworks factories is either 1,910 or 2,503. Using GOFI data, Damietta is shown as having the largest number of factories at 565, followed by Sharkeya at 515, Cairo at 481, and Giza at 156. It is worth pointing out, however, that both these sources only include in their statistics "industrial" entities that comply with the Ministry of Industry's definition for industrial establishments. It follows that most workshops and small factories are not included. Data obtained from the Commercial Registry indicates that the total number of companies producing furniture and woodworks final products is 54,097. According to the Ministry of Local Development, on

the other hand, the total number of workshops registered with furniture and woodworks cooperatives is 89,612. Damietta has the highest concentration of workshops (23,082), followed by Cairo (14,163), Dakahleya (6,973), and Giza (6,656).

In addition to the furniture manufacturers, as shown in Table A6-1, are 8,213 factories producing intermediate products. These are feeding industries. While some of the furniture and feeder factories employ more than 100 employees, most are much smaller, with only 5-10 employees. Of the factories registered at the commercial registry, 988 had capital greater than £E50,000, while 59,477 had capital less then £E50,000.

A small subsector of the furniture sector is military production. Information on factories affiliated to the National Organization for Military Production and the Arab Organization for Industrialization revealed that in 2002, Factory No. 54 had the highest value of production at £.E. 2,700,000 and employed 122 workers. The Motor Company's factory has the second highest value of production, employing 170 workers and producing furniture and woodworks commodities worth £.E. 1,965,000.

Table A6-1
Furniture and Woodworks Feeding Industries

Activity	Total Number of Entities
Upholstery	1,687
Furniture Upholstering	2,452
Car seats upholstering	1,089
Paints and varnishes	597
Upholstery – Other Activities	93
Furniture Gilding	512
Mattresses and cushions upholstering	453
Spinning and weaving equipment	258
Nails	221
Plywood and straw manufacturing	139
Woodworking machinery	123
Shoes and Floors varnishes	89
Veneer wood manufacturing	69
Adhesives	68
Pasting materials other than adhesives	58
Door locks	50
Abrasives	48
Sponge mattresses	41
Furniture and fixtures other than metal and upholstery	38
Doors and other Hinges	36
Pressed and particle board manufacturing	26

Activity	Total Number of Entities
Door Knobs	18
Furniture packaging and packing	14
Glues	13
Furniture and metal polishers	12
Panel board manufacturing	9
Total	8,213

This information provides an important example of something that needs to be improved. Since statistics provide insights about trends, relative importance of industries in the global and/or domestic markets, etc., better statistics that comply with international standards and are readily available via the internet would greatly improve the quality of decisions made by government, industry, and financial institutions.

Further, the system of data gathering and processing used by the customs and tax authorities and CAPMAS must also be improved. There appear to be important discrepancies in follow international coding, classification, and documentations systems developed at the United Nations. As a consequence, statistics forwarded to the CAPMAS tend to be misclassified, causing statistics published by government authorities to be inaccurate and unrepresentative of actual trade flows. It is recommended that the customs and tax authority documentation systems be revised to coincide with international standards and practices developed by the United Nations. CAPMAS systems of information gathering and analyzing would benefit from updating computer hardware and software systems and networks.

This is an industry strongly affected by tariffs and non-tariff barriers on imports into Egypt and exports to foreign markets. A factory that is making furniture for local consumption will be adversely affected by the reduction of protective import tariffs on furniture but will benefit from lower costs of raw materials. A company making furniture for export will benefit from the reduction of tariffs on imports reducing raw material costs and the reduction of tariffs in the export market making the furniture more cost competitive. Of course, some companies produce furniture for exports and domestic consumption.

Most furniture is made for domestic consumption. Raw material consists of wood, glue, stains, and hardware that must be imported along with wood-working machinery. Plywood, veneer, medium density filled wood all have a 40 percent tariff rate. Paints, stains, and glues carry a 30–33 percent rate. Wood is 22 percent or more when metal parts and accessories are added. While the United States is a better source for some of these, it is too expensive to buy them from the United States when compared to the reductions under the EU-Egypt Association Agreement. This may be an example of trade diversion.

In Egypt, there is a huge importation of wood for furniture to be exported or used domestically. Most hardwood comes from Romania and some comes from France. This will

be subject to declining tariffs under the Agreement. Soft wood comes from the EU but is considered as an agricultural commodity, and thus is not yet subject to duty reduction. In any case, the reduction of tariffs does not come until the last phase of the EU-Egypt Agreement. In total, Egypt imports wood from 11 countries, including Russia, Finland, and Indonesia. There is little importing of wood from the United States, but if there were a FTA, it might be more cost effective especially if whole logs could be imported. According to industry sources, the additional transportation cost for importing wood from the United States would not be a significant cost consideration.

The higher raw material costs from a devalued £E have increased the price of raw materials and of Egyptian finished products to the local customer. The result is reduced domestic sales revenue. *[When 2003 statistics are available check amounts.]* Given the 30 percent increase in the cost of raw materials resulting from the £E devaluation, and assuming that raw materials comprise one-third of the cost of the product (this percentage would vary according to type of furniture), cost of the product would increase 10 percent. This increase could be offset by the elimination of tariffs on raw material imports, which range from 5 percent to 33 percent, as shown in Table A6-2.

According to the TradeMap data, Egyptian furniture imports declined about 10 percent per annum during the period 1998-2002. The largest category of wood furniture imports is other wooden furniture, followed by office furniture, then bedroom furniture and kitchen furniture.

The domestic market-oriented furniture manufacturers are protected by the cost of imports being increased by a 40 percent duty rate plus other fees. If tariffs and non-tariff barriers to entry for imports are eliminated for FTA partners as they will be for the EU, Egyptian companies will, in time, be vulnerable to greater competition from foreign, lower-cost products made by manufacturers that have the benefit of lower labor rates or highly automated factories. Under the EU Agreement, Egyptian furniture producers have some time to improve their efficiencies and competitiveness because the tariff rate will stay at the 40 percent level until 2008 when it will be reduced slightly to 36 percent. In 2011, it is schedule to be reduced to 18 percent and in 2014 to 0 percent. A similar schedule should be negotiated with the United States.

One furniture manufacturer was very pessimistic saying that the Egyptian manufacturers of low-end furniture will not change much in the next 10 years, meaning that they would not improve efficiency or reduce costs of manufacturing. He thought the result could be a loss of 500,000 jobs based on when the tariff rate was reduced from 50 percent to 40 percent *[date],* causing a ripple of bankruptcies of a number of large manufactures with workers losing their jobs. *[Check and get more details.]*

All Egyptian furniture manufacturers face the same problems when importing raw materials. Egypt is working under the customs law of 1967. Customs brokers are terrified about making a mistake. A company can clear customs quickly if it is willing to pay the higher cost initially imposed by the customs official. For example, one manufacturer was

charged £E500-600 in import duty for a single compact disk (CD) containing patterns from a prospective customer. Another manufacturer had a color sample for upholstery fabric cost £E500-600 in import duty. By negotiating with the customs official these amounts can be significantly reduced, but this increases costs to exporters making them less competitive in the global market. Exporters should also receive temporary admission or duty drawback on import duties and sales taxes paid on the imported inputs used in the production of their exports, but these procedures do not work well. Especially for smaller exporters, the frustration of dealing with always changing customs rates, requirements, and procedures can be very discouraging.

Table A6-2
Total Imports and Custom Duties, Sales Tax and Service Fees Paid by Importers of Wood and Wood Products (US$ 000,000)

Product Name	Category	1999	2000	2001	2002
4407100000 Lumber, coniferous (softwood) thickness < 6mm	Total Imports	369.32	388.05	321.56	311.23
	Customs Value (8%)	29.55	31.04	25.72	24.90
	Sales Tax (5%)	18.47	19.40	16.08	15.56
	Services Fees (0%)	0.00	0.00	0.00	0.00
4407920000 Beech lumber, lengthwise chipped, thickness > 6mm	Total Imports	80.35	83.20	88.00	82.97
	Customs Value(8%)	6.43	6.66	7.04	6.64
	Sales Tax (10%)	8.04	8.32	8.80	8.30
	Services Fees (2%)	1.61	1.66	1.76	1.66
4412190000 Plywood consisting solely of sheets of wood, each ply not	Total Imports	54.45	63.16	72.02	75.31
	Customs Value (10%)	5.45	6.32	7.20	7.53
	Sales Tax (0%)	0.00	0.00	0.00	0.00
	Services Fees (0%)	0.00	0.00	0.00	0.00
4403201000 Logs, poles, coniferous not treated or painted, squared	Total Imports	31.99	25.14	18.17	17.52
	Customs Value (5%)	1.60	1.26	0.91	0.88
	Sales Tax (0%)	0.00	0.00	0.00	0.00
	Services Fees (0%)	0.00	0.00	0.00	0.00
411210000 Fiberboard of a density exceeding	Total Imports	2.44	8.21	8.93	10.96
0.5 g/cm3 but not exceeding 0.8 g/cm3; Not mechanically worked or surface covered	Customs Value (20%)	0.49	1.64	1.79	2.19
	Sales Tax (5%)	0.12	0.41	0.45	0.55
	Service Fees (2%)	0.05	0.16	0.18	0.22
4407910000 Oak lumber, lengthwise chipped, thickness > 6mm	Total Imports	15.05	9.55	7.33	8.70
	Customs Value (8%)	1.20	0.76	0.59	0.70
	Sales Tax (0%)	0.00	0.00	0.00	0.00
	Services Fees (0%)	0.00	0.00	0.00	0.00
4412290000 Panels with at least one outer ply of non-	Total Imports	6.53	4.67	8.47	6.07
	Customs Value (33%)	2.15	1.54	2.80	2.00

Product Name	Category	1999	2000	2001	2002
coniferous wood	Sales Tax (0%)	0.00	0.00	0.00	0.00
	Services Fees (0%)	0.00	0.00	0.00	0.00
Total Value of Imports	572.35	594.06	541.63	533.07	
Total Customs	46.87	49.22	46.04	44.83	
Total Taxes and Service fees	28.28	29.96	27.26	26.29	
Grand Total	75.14	79.18	73.31	71.12	

Potential growth in exports is high but furniture producers cannot take advantage of this potential because they have to self-finance growth. They are also limited in access to hard currency as discussed earlier. These firms can grow, create jobs, and add to the economy if there is access to capital either through investors and/or bank loans. Thus, the financial services sector needs reform.

To meet the competition that is present in foreign markets, Egyptian manufacturers are starting to innovate and change. But, most entities are too small to compete internationally against larger companies. Industry leaders said they need a center technology information center. One benefit could be the incubator infrastructure including website design that is very important in international marketing.

A key element of export success for this sector is to know the "tastes" or product feature preferences of the consumers in different markets. Furniture exporters realize that the flexibility to meet the design preferences of the foreign market is a key to success. This is very complicated because even within a given country, consumers will prefer different styles and features according to their lifestyle, level of education, ethnic background, etc. Egyptian furniture producers are concerned about producing the "right" products for the "right" market. It is impossible to know these markets unless a lot of money is spent on market research and finding the right distributors. This can be facilitated by producers working in syndicates.

Mechanisms for companies to work together will have to be developed. One furniture manufacturer suggested syndicates of 6-12 companies that would collaborate and share marketing and distribution costs. A syndicate could either have staff to promote directly into foreign markets or could negotiate with an exporter to represent them. A syndicate would have more leverage to get better prices than each company would have on its own.

The "clustering" of furniture production in Damietta, Sharkeya, Cairo, Giza and Alexandria can be very beneficial to creating competitive advantage if mechanisms for furniture industry market intelligence, marketing collaboration, management and employee training, improved communication/buying between vertically integrated companies, and financing of imports and exports can be created.

Tunisia created clusters with the result that Egyptian handicraft people went by the thousands to work in Tunisia. *[need more details – lessons to be learned]* In Italy there is a furniture manufacturing triangle (cluster) that claims to export 70 percent to 80 percent of chairs imported into the United States. *[check this – lessons to be learned]* A manufacturer will produce the same basic design with 20 small changes so each customer has a unique piece and will pay the higher price for it.

Since 2003, the Industrial Modernisation Centre has been working with formal and informal furniture factories and workshops in the Domiat Governorate *[check name, is it a different spelling for Damietta]*, some of them quite small with fewer than 10 workers. Showings at two exhibitions have been organized. Eleven Domiat furniture producers exhibited at INDEX–Dubai, one of the 10 largest furniture exhibitions in the world and the largest in the region. After INDEX-Dubai, a group of international experts began a pilot program in Domiat to rehabilitate 15 producers and 40 workshops, improve quality of production, and enhance their capability to succeed in new export markets. An extensive training program was established. Domiat producers also exhibited together at the Salon du Meuble in Paris during January 2004. If the producers in this pilot project continue to be successful, it should be replicated in other areas where there are concentrations of furniture producers.

Another way to export successfully would be as a sub-contract manufacturer for a U.S. or EU furniture company. Many U.S. furniture companies are suffering from high costs of manufacturing and could benefit from establishing a manufacturing contract, setting up a joint venture, or acquire one or more companies in Egypt. The U.S. company would provide the market intelligence, market access, and design expertise for the tastes of the U.S. market. It might also assist with the financing of growth if there were more financing sources available.

When exporting, furniture producers have to exchange 75 percent of hard currency into £E. The government pledges to make available this currency within 3 days in order for the company to import components, which is very important in this sector. Remittance is repeatedly postponed with the statement that the situation is not the government's problem. Delivering on the 3-day pledge is critical for companies that have to import raw materials. Egypt does not have the wood that is needed. Furniture companies go to the black market and pay a premium for exchange currency cutting into profits and reducing the ability to grow the business.

There is a program making hard currency more available if the company imports everything itself. Unfortunately, furniture producers cannot benefit because then need hundreds of items and have to use other companies to source some of them. The solution would be to relax the requirement that all imports be brought in directly by the producer. In addition, the factors causing a second foreign currency market should be eliminated.

The past decade has brought about significant changes in wooden furniture markets, for example in material compositions of furniture, competitive positions of producer countries,

and designs and finishes of furniture, as well as retail and promoting practices, networking, and distribution patterns.

The following trends should be incorporated in the strategic planning for the growth of the furniture sector:

1. Taking advantage of outsourcing of semi-finished products and components from developing countries.
2. Tightening environmental regulations and mounting pressure for certification and labeling requirements on furniture (especially in the United States in the next 2 to 3 years).
3. Experimenting with new material combinations (wood, natural fibers and synthetics).
4. Adoption of Internet in export promotion, growing business-to-business electronic commerce, and centralized electronic procurement of operating supplies.

A7. Pharmaceutical Products

There are basically four types of companies in the pharmaceutical sector. First there are the public sector companies. Within the private sector are the Arab Company for Drug Industries and Medical Appliances (ACDIMA) companies, local companies, and multinational corporations (MNCs). There are some differences in how each will be affected by trade liberalization and what they need to thrive.

In 1999, there were 8 public companies producing 18 percent of total industry production but their sales only amounted to 8 percent of total revenue indicating that their products were priced lower than the industry average. Their drug exports were 63 percent of total pharmaceutical exports. For the most part, these companies are over staffed and inefficient. At least five of these companies are listed on the stock exchange with 23 percent-30 percent of their shares held by the private sector and 10 percent reserved for the Employee Shareholder Association. *[Update all of this]*

ACDIMA was established in the 1970s to create a vertically integrated group. In 1999, there were 7 affiliated companies: 4 producers with 10 percent of the private-sector market share and 3 packaging companies. These companies enjoy an exemption of the 2.5 percent-5 percent tariff imposed on imported active ingredients. *[Update all of this]*

Sales of the local companies, mostly over-the-counter and generic drugs , amounted to 11 percent of private-sector revenue in 1999. These companies have been growing because of flexible product mix based on short runs that the public sector and MNCs cannot achieve, competitive sourcing of ingredients, production under license for foreign companies that provide expertise and access to technology, and ability to sell generic products to export markets, thereby avoiding government-imposed price ceilings on products for the local market. *[Update all of this]*

There were 8 MNCs based in Egypt in 1999, accounting for 37 percent of total private-sector sales. These companies focus on proprietary drugs, owned and produced by their parent companies. On the one hand, they have an advantage in producing innovative drugs that have little competition at the high-quality, high-efficacy level. On the other hand, they are dependent on importing expensive raw materials and they face lower-price competition from locally produced generic drugs. The MNCs are not significant exporters. *[Update all of this]*

A. IMPORTS

The pharmaceutical industry has very large imports of raw materials and some finished products. The total value of imports in 2002, excluding vitamins, was $248 million, most of which comes from Europe. Egypt's imports of pharmaceutical products from the U.S. in 2002 were only $22 million.

The 2003 tariff rates were 5 percent for antibiotics, 10 percent for medicaments in dosage form (pills, capsules), and 1 percent-10 percent for medicaments not in dosage form (liquids, sprays, ointments), plus a sales tax of 10 percent. If, however, the imported raw material is to be used for the production of an essential drug, then only 1 percent customs duty is imposed and the sales tax is removed. These relatively low tariffs are in accord with the government's social goal of ensuring that medicine is affordable to most of the population.

Under the EU-Egypt Association Agreement, the Egyptian tariff for antibiotics is scheduled to decline to 0 percent in 2005, and medicaments to 0 percent in 2014.

In 1999, the government strictly controlled the types of drugs that could be imported with the exception of breakthrough products and products that could not be manufactured locally. This protectionism should vanish once the Trade Related Aspects of Intellectual Property Rights (TRIPS) is applied. *[update]* The ostensible purpose of this restriction was to protect the property rights of local producers, both public and private. They will face greater competition when TRIPS is applied.

Typically, prescription drugs are available in Egypt within a year of their being introduced in the United States or EU. Of the prescription drugs on sale in Egypt, it is estimated that 80 percent are manufactured locally (proprietary drugs by the MNCs and generics by the public and local private companies) and 20 percent are imported.

The major problem facing the pharmaceutical industry is that the Ministry of Health sets all pharmaceutical selling prices through the Pharmaceutical Pricing Committee at the Drug Planning and Policy Center (DPPC). Controlled prices were established in 1991 under Ministerial Decree 314. In 1995, a new method of pricing was introduced named the "cost plus formula" which allowed a fixed margin above the cost of ingredients; 15 percent on essential drugs and 25 percent on non-essential drugs. The Schedule of Costing covers raw materials, labor, packaging, and labeling with a profit percentage to be split between the

pharmacist, producer, importer, and others in the value chain. Once a selling price is set, however, it is seldom reevaluated to reflect inflation or any changes in costs of raw materials, labor, etc.

The pharmaceutical manufacturers complain that these prices have not been adjusted over the years for devaluation and inflation. For example, devaluation of the £E since 2002 has meant roughly a 100 percent increase in the cost of raw materials that can make up to 90 percent of the cost of the products. As a result, some companies say, they are no longer making profits on a number of product lines and are having to use reserves to cover costs. One company we visited appeared to be running at less than half of capacity. When asked about the situation, the CEO said that he could not produce some products because he was losing money on them. *[What is situation in other factories?]* When the reserves are depleted, these companies could go bankrupt. The alternative is to orient sales towards the export market, which would lead to shortages on the domestic market.

There is disagreement between the pharmaceutical manufacturers, pharmacists, and the Ministry of Health on the issue of how much pharmaceutical companies are being harmed by price controls and whether the system should be changed. The pharmacists claim that manufacturers are exaggerating their difficulty in order to get a greater percentage of the profit margin. *[Check how this margin is determined and the extent to which real prices of pharmaceutical products have declined.]*

Some industry leaders believe that the Minister of Health is ignoring recent rulings to liberalize pricing policy. *[check this]* It is also said that arbitrary decisions are often made on the price at which a specific product is to be sold. *[Is this true? Ask more industry people about this.]*

The regulatory environment governing the pharmaceutical sector is laden with bureaucracy that is evident in both pricing and the registration system. Prices set by the committee do not take into consideration R&D or promotion expenditures. Thus very little is spent on product development or marketing. In order to import drugs, importers have to obtain an import license that allows a specific quantity of the drug to be imported at a specified price. This license has to be renewed on an annual basis. The result is additional costs to pharmaceutical companies that are already working on slim margins.

Processing imports through customs is an excruciating process because of the many agencies involved and the specialized knowledge that is required. This adds substantially to costs.

As of 1999, a pharmaceutical product could not be registered in Egypt unless it was already registered and sold within one of 17 specific countries. *[update]* This causes delays in registering products that are not from these countries but do have high medical value to consumers. Anything developed in the United States and approved by the FDA is approved here. The approval process is centralized under the Minister of Health, including the licensing of products and maintenance of quality control.

Very little R&D leading to proprietary drugs is done in Egypt. The focus is more on reformulations. *[Check whether there is pharmaceutical related R&D done in universities that would provide an Egyptian company with a comparative advantage; reformulations, new methods of delivery, biotech, local plant actives, research on local diseases, other? Maybe no need for R&D if there is enough market need for high quality, low-price manufacturing of generics and licensed medications for sale in local markets. Check.]*

In September 2003, the Ministry of Health and Population sent a formal memorandum to the Jordanian Association of Manufacturers of Pharmaceuticals and Medical Appliances agreeing to begin registering Jordanian drugs. Jordanian companies will now begin presenting their products for laboratory analysis and pricing to enter the Egyptian market. Initially this will involve registering between 2 and 5 products from six companies of 5 different types of medicines.

B. EXPORTS

Most pharmaceuticals are manufactured for local consumption. In 1999, only 6 percent of production was exported. In 2002, exports were $39 million, or 10 percent of Egypt's production. Medicament mixtures in dosage form were $24.8 million, medicament mixtures not in dosage form were $7.0 million and antibiotics were $7.3 million. Compared with other Middle Eastern countries this percentage is very low. For example, Jordan exports 40 percent of its pharmaceutical production. *[The size of the population and domestic consumption in the two countries would be one factor contributing to the difference. What are the other reasons?]*

About 75 percent of pharmaceutical exports (including supplies, medicaments, and veterinary medicaments) go to the MENA countries. There are at least 170 Egyptian medicines, for example, in the Jordanian market. By contrast, Egypt's exports of pharmaceutical products to the United States have been valued at under $10,000 in each of the years 2000, 2001, and 2002 and exports to the EU are only 2.5 percent of total exports. [Is there a growing market opportunity in MENA? COMESA? US and EU for low-cost generics, if they are low-cost and if they would meet FDA and EU standards?]

Given the low level of prices allowed in Egypt, more companies are likely to export their products to countries where constraints on prices are less binding. This trend may be reinforced by the devaluation of the Egyptian pound. This could help to shore up the losses from domestically sold products. However, it might also cause companies to allocate more production to exports thereby creating shortages in the local market that could lead to the development of a black market with higher prices and lack of quality control. To expand exports, Egyptian companies will have to maintain consistently high quality standards and improve marketing channels.

As of 1999, pharmaceutical products were excluded from patent protection while patents on their manufacturing process were granted for 10 years. Recently, Law 82, covering intellectual property was passed and will be applied to pharmaceuticals in January 2005.

This will be a benefit to the MNCs and a limitation on local companies that currently produce patent-infringing generics.

Bank financing was available until 3-4 years ago. Now it is difficult to get loans and hard currency. The result is a decrease in importation of raw materials and machinery essential for this industry to survive. *[Check this]*

Rules of origin is not an issue when exporting to African countries and Gulf states.

[Still to do: more on TRIPS, quality control, upgrading of manufacturing, use of IT as essential part of manufacturing efficiency and link with customers.]

A8. Marble and Ceramics

A. MARBLE

Egypt is one of three countries producing the highest quality marble in the world. Egypt is highly competitive in the international market for marble because the quality of Egyptian marble is equal to or possible better than either Italian or Spanish marble and the sale price, partly due to devaluation of the pound, is half of their sale price. There are virtually unlimited quantities of raw material within Egypt. It is harder and has better consistency, with few defects or cracks due to Egypt's dry climate. Cracks come from rain freezing and thawing, so that part of the preparation process for Italian and Spanish manufacturers is to fill the cracks and holes with resin. Marble quarries in Italy and Spain are also getting old, with their reserves being depleted while labor costs and taxes are high.

In 2002, Egypt exported 402,000 tons of marble with a value of $60 million. Between 1998 and 2002, the annual growth in quantity exported was 73 percent while the $value grew by 63 percent per annum, indicating a decline in the price per ton. Egypt is the third largest exporter of marble in the world, having 8 percent of the global market, and its exports are growing 53 percent more rapidly than total world exports, indicating that Egypt has a very significant competitive advantage in this industry.

Although Egypt exported over 400,000 tons in 2002, 96 percent of this total went to China and Italy, where most of it was polished and finished before being shipped to its final destination. Firms will be able to perform these operations in Egypt once they have the right equipment. Most Egyptian companies lack the block, sample, and individual tile cutting equipment that is essential to being competitive at the finished level.

Block cutting is primitive and wasteful using explosives. For every five tons of quarried material, four tons are waste and one ton is useable. Large diamond-tooth saws, which can be imported from Italy, Turkey, or India, can improve that ratio considerably, but they are very expensive and these many firms do not have access to the capital required to purchase

them. However, investing in the right machinery will enable these firms to move into rapidly growing markets in Europe, Asia, and the United States.

Most companies in this sector are SMEs with potential to grow through exporting if the business environment were more supportive. As an example of how some Egyptian businesses have moved into the export market, one Egyptian company collaborated in the mid-1990s with an Italian company, which provided technical and financial support to improve the production process, as well as marketing in Eastern and Western Europe. Over the next few years, the Egyptian company learned more about the market, attended two expositions per year, and had their marble used in prominent buildings that they could then displayed as examples of their work.

Three years ago, the Egyptian company decided to also sell directly into the markets covered by the Italian company. This year, they will exhibit at 15 expositions in Italy, Germany, United States, India, China, Syria, Portugal, Spain, England, Russia, and Saudi Arabia. Their marketing costs of $450,000 are expected to generate $17 million export revenue this year compared with $13 million in 2003. They are currently exporting to about 40 countries.

The management of the company recognized that they needed to improve their management, financial, and administrative practices to be globally competitive. As a result, they hired two university professors as consultants. These consultants were expensive but management believes the improvements that have been implemented thus far outweigh the cost. Some examples would be: employees are beginning to work as teams rather than as individuals; administrative staff is becoming more skilled through in-house, self-funded training; improved financial and information systems have been installed; quality control systems are in use. The company is working on creating a production line.

One problem is that not all firms share equally in this record of success. Marble production is intensive in its use of semi-skill labor at the finishing, polishing, and packaging stages. There are approximately 300,000 employees in the marble industry in Egypt. Approximately 50 companies employ more than 200 people, while another 450 companies employ fewer than 200 people. Many of the smaller firms have difficulty competing in the world market on their own. The marketing costs associated with exporting are too high and the exporting process is too complicated. These companies, rather than viewing each other as a competitors, might work together to be more efficient and to capture market share from foreign companies. But for now, they remain oriented towards the domestic market.

The import duty rate on marble is currently 15 percent. This was reduced from 43 percent in January 2004 to equal Egypt's bound rate under WTO. The higher tariff may have been in place to protect smaller firms in the domestic industry against imports, even as the larger firms were exporting very successfully. Tariff rates are scheduled to decline under the EU-Egypt Association Agreement over a 12 year period, independently of Egypt's commitment under WTO. The emphasis during this period should be on assisting the industry to

restructure in ways that will give it a stronger export orientation and help some of the smaller firms to band together to develop their export markets.

Standards are important in the marble industry just as they are in many other industries where Egypt has a presence. Starting January 1, 2005, no Egyptian marble will be allowed into the EU unless it has met the standards requirements for the "CE" (Conformité Européenne) mark. The cost of compliance is estimated at €20,000. Each Egyptian company wanting to export to the EU will have to go through the application and investigation process and incur this cost. Many companies will need a bank loan to pay this fee but SMEs don't have ready access to bank loans. *[check that this is true. Is there a way the companies could work together on the certification to decrease paperwork and cost?]* The Industrial Modernization Center may help with this certification and with modernization of the manufacturing process.

A major problem for Egyptian marble exporters is the exchange rate system. While marble exporters have benefited very much from devaluation of the Egyptian pound, they are unable to acquire access to foreign exchange to purchase inputs within a reasonable period of time at the bank rate of exchange. Instead, they are forced to go to the parallel market where they pay a considerable premium. Yet 75 percent of their net export earnings must be converted into local currency at the bank rate. Thus machinery, wood, and other imports cost £E7 per US$1 while their exports earn them about £E6.15 per US$1, making costs of inputs about 14 percent higher than they would be if there were a single currency exchange market.

There is also a disincentive to importing needed machinery: customs duties and the 10 percent sales tax. Although these taxes are refundable (in theory) if paid on imported raw materials or intermediate goods used in the production of exports, they are not refundable when paid on equipment. Furthermore, there is no credit available for this investment on the corporate profits tax. This is a strong discouragement on investment in modern machinery, which is required to compete in the global marketplace

The customs clearing process is cumbersome and time-consuming, which can lead to expensive storage charges while the goods wait to be cleared. There are also delays with clearing the General Organization for Import and Export Control (GOIEC). To facilitate the process, payments have to be made to customs and other officials. For example, there is a 3 percent surcharge that is paid to customs

These taxes are working against the goal of bringing Egyptian industry up to world standards so it can compete successfully. An Egyptian company could easily have to pay 50 percent more than its competitor in another country when buying a piece of machinery through customs duty, sales tax, currency exchange premium, storage fees, and customs surcharge. This puts it at a serious disadvantage when competing against marble from other countries that do not impose these fees.

Every company has had its experiences of serious problems with customs clearing of imports. Valuation is a major problem. Customs officials are not qualified to determine the

classification of goods. In the marble industry, an example was a crate returning from an exposition where samples of Egyptian marble were shown. The customs official declared that the samples were Italian not Egyptian marble. Even though the company protested, a duty was levied on them. Another crate returning from an exposition contained 55 promotional CDs that were not on the bill of lading. Because of this small discrepancy it took an extra day to clear customs, adding up storage fees and additional costs to processing through customs.

There are also significant problems with exporting. People who approve export clearances are so slow and the delays can be such that the shipment misses the scheduled ship. Two serious problems are then created. The delay in delivery can delay the completion of the entire project, (government building, hotel, etc.) ruining the reputation of the marble company and lowering sales potential. The other problem is that on the next ship there may not be enough room for the entire shipment and in some countries (e.g., China) the goods will not be accepted unless the entire shipment is complete.

It is customary in this industry to pay tax inspectors who come frequently to check the companies' books. The entire corporate profits tax process increases the costs of the company, again making them less competitive in the world marketplace. Since the tax inspectors do not actually audit the company, the tax reports and statistics are not accurate.

The cost of transportation is high at 30 percent of total cost. Roads in the vicinity of the quarries are in very bad condition and should be improved to reduce accidents, safety problems, and the high cost of vehicle repair. There should be services in Sheikh Fadhl, Khashm Al Rakabah, and Al Galah such as police, ambulance, gas stations, and car and truck repair.

Quarries are burdened with unnecessarily frequent administrative procedures. The lease time to utilize the quarry is very short; it should be at least 10 years. Marble companies get an extension every year to utilize the quarry and each year they get a new number. The annual number change causes confusion and administrative problems with tax and other authorities. Every six months, approvals are needed from the military authorities, creating more burdensome red tape when the approvals could be annual or every two years.

Quarries have to follow a very long procedure to obtain explosives used to cut stone. These procedures should be streamlined.

B. CERAMICS

During 1998-2002, exports of ceramic tiles and other ceramic building materials increased by 40 percent per annum while imports of these products declined by 22 percent per annum. Most of the exports go to countries in the Middle East, but markets have also been developed in Europe and the United States. The U.S. market, in particular, is growing rapidly as homeowners increasingly prefer real ceramic tiles to synthetic products.

This has been an industry that was perceived a few years ago to be seriously threatened by imports. It has been subject to overcapacity and is excessively dependent on the domestic real estate market, which fluctuates widely. This has made it difficult to keep costs down. Furthermore imported raw materials, such as glaze and stains, account for about 60 percent of the value of the final product. This has meant that the industry was severely injured by devaluation as long as ceramics were being sold primarily on the domestic market.

Reorientation towards exports during the past few years has been led by a few of the larger firms in the industry producing high quality tiles, which are comparable to those being produced in Spain. These firms use designers in Italy and Spain, from which they also import most of their raw materials.

A major problem relates to the time required for shipments to arrive at their final destination. Although freight rates are comparable with those of Italy or Spain, Egypt's most important competitors, because of inadequate volumes, exports must be shipped to bulking points in Europe before they go on to the buyer. This requires holding buffer stocks for "just-in-time" delivery in the United States or other markets, which is costly.

Other major problems relate to the payment of high duties and sales tax on glazes, stains, equipment, and spare parts. Duty drawback payments are received, but their assessment is very arbitrary and delays of up to six months are common. Because of long delays in obtaining foreign exchange from banks, most firms buy foreign currency on the parallel market, which is costly. Customs and port clearance is expensive, cumbersome, and slow.

A major need in the ceramics industry is for clustering among firms to share marketing expenses and research costs. It might also help to support a domestic glaze industry and to stock spare parts locally. This is common in Italy and Spain but has not worked thus for in Egypt. This is an example of the economies of agglomeration that are required increasingly in international trade.

A9. Motor Vehicles and Tractors

The automotive industry can be divided into automobile production and other vehicle production, i.e., buses, trucks, and farm equipment.

Total value of equity in the local vehicle industry is about £E34 billion ($580 million), compared to £E1.3 billion ($200 million) in equity of food industry companies. Total investments in the vehicle industry are valued at £E7 billion ($1.1 billion), compared to £E2 billion ($320 million) in the food industry. *[check whether all vehicles or just automobiles]*

The automobile subsector is dominated by large multinational companies. The other vehicle subsector contains more medium-sized and Egyptian companies. The automobile sector is growing. In February 2004, Secretary General of the Egyptian Automobile Manufacturers

Association, Eng. Salah Al-Hadhari, announced that about 13,000 vehicles were made during the first half of 2003.

The extent of new car sales during the first nine months of 2003 came to 35,000 cars, compared to 33,000 in the same period in 2002. Sales in November 2003 were up 60 percent, amounting to £E725 million ($120 million), compared to £E450 million ($75 million) in November 2002. New car sales grew 25-35 percent, in terms of number of cars sold as well as their value, resulting from the rise in the rate of exchange of the U.S. dollar and the rise in price of cars in the international market. Factors contributing to this success were the devaluation of the £E and high tariffs on automobile imports. This is a highly protected sector with a tariff on imports of 135 percent on cars and 40 percent on trucks.

HS Code (Motor Vehicles)		Exports		Imports		2003 Tariff Rate (%)
		2002 (mil $US)	Change 1998-2002 % pa	2002 (mil $US)	Change 1998-2002 % pa	
870310	Cars (incl. station wagon)	0.45	-27	171.99	-20	135
8704	Trucks, motor vehicles for the transport of goods	1.31	134	99.72	-22	40

Clearly, when free trade agreements require the reduction of these tariffs, the local manufacturers will face increased competition. Below is the schedule for tariff reductions under the EU free trade agreement.

HS Code (Motor Vehicles)		Trade Agreement Commitments						
		WTO Bound Duty	EU-Egypt					
			2002	2005	2008	2011	2014	2017
870310	Cars (incl. station wagon)	60-160%	135%	135%	122%	81%	41%	0%
8704	Trucks, motor vehicles for the transport of goods	20-60%	40%	40%	36%	18%	0%	0%

In November 2003 it was reported that, Bavaria Auto Trading, Egypt's BMW Group representative, will invest approximately $60 million in a new assembly plant to be located on the outskirts of Cairo to produce 3-series and 5-series cars. The factory will be built in the 6th of October City and will have an annual production capacity of 4,000 cars. Some 1,500 to 1,800 cars will be assembled in the first 12 months of operations. Output will be marketed in Egypt and Common Market for East and Southern Africa (COMESA) states.

Bavarian Auto Trading was awarded the exclusive rights for assembly, importation, distribution, and after-sales support for BMW Group products in Egypt this past March. The German car manufacturer failed to renew its license with former representative

Hossam Abul-Fotouh over financial irregularities. The new group consists of a consortium of Egyptian, Gulf, and German investors.

Egypt is the fifth largest market for BMW in the Middle East and North Africa region, after Dubai, Saudi Arabia, Abu Dhabi and Kuwait.

The Cabinet gave special concessions to Nissan to to establish a hub in Egypt. Fifty percent of production must be exported including components that are made in Egypt. Automobile assembly done in Egypt is for the African and Arab countries. Nissan will do technical training to upgrade and support R&D for support (feeder) companies such as components and spare parts.

General Motors has been operating in Egypt for quite a while. General Motors has a 31 percent equity interest and management responsibility in a joint venture company, General Motors Egypt (GME). Isuzu Motors has a 20 percent equity interest, and the Mansour Group is the largest Egyptian shareholder in GME, with a 16 percent stake. Other individual Egyptians have a 33 percent interest, and Saudi investors have a 16 percent interest. The plant is built on a 36-acre site, with 270,000 square feet of floor space in the Sixth of October City, just west of Cairo. GME produces light and medium-duty trucks with Isuzu and Chevrolet brand names, as well as Opel passenger cars and Chevrolet trucks.

In 2001, there was an enormous drop in vehicle and vehicles exports from Egypt to the United States. In 2000, $2.6 million was exported. In 2001 and 2002, the amount dropped to $47,000 and $42,000. *[What was the cause? What type vehicle?]* This trend may have turned around because the amount was $59,000 for the first two months of 2003.

In 2002, 8 percent of Egypt's imports from the United States consisted of vehicles and vehicle parts, mostly the latter. The amount was $229 million which is consistent with the previous two years.

A prominent subsector is manufacturing buses, which are selling well domestically as well as exporting. However, if Scania and Mercedes trucks were able to come into Egypt without paying a 40 percent tariff plus other fees, they would take more of the market. Egyptian companies would have to increase their usage of local components to compete. This could be a benefit to Egypt as it might cause new feeder businesses to be created and would increase sales of existing feeder businesses.

A change in the tariff rate on buses will have little effect on the bus manufacturers because the tariff rate on imported tourist buses is only 5 percent.

Local bus manufacturers have the problem that the tariff on imported components for buses is 15 percent, higher than the rate for importing a finished bus. However, because some components are locally produced and labor in Egypt is less expensive (it takes 3,000 man-hours to manufacture a bus) it is cheaper to make buses in Egypt than to import them.

The same situation applies to tractors where the import duty on a finished tractor is 5 percent and on components is 15 percent. Still a local producer's total cost will be half the cost of the imported tractor because 90 percent of components are produced locally.

Recently there have been some announcements of collaborations with foreign companies for new, reduced emissions busses. The foreign company brings new technology and products meeting international standards to its Egyptian partner. Generally, bus manufacturers make the body and chassis and import the engines. These collaborations should be encouraged.

Egyptian Automotive Company, the leading bus manufacturer in Egypt in collaboration with Cummins Westport Inc., announced in 2003 that their joint market entry would begin with a display of the low-emissions B Gas Plus natural engine in a 40-foot Egyptian Automotive transit bus at the Cairo International Fair, the largest in the Middle East. The bus and engine, which were ordered by Cairo Transit Authority, brings the total to 100 the number of C series engines in use at the Greater Cairo Bus Company and the Cairo Transit Authority.

Cummins' Westport C Gas Plus low-emissions natural gas engines will be installed in transit buses manufactured by Thomas Bus. This engine order is the initiative of the United States Agency for International Development (USAID) under the Cairo Air Improvement Project (CAIP). CAIP monitors air quality and funds air quality improvement projects in Cairo, and instituted the first vehicle emissions testing program on the African continent.

One of CAIP's key initiatives is to encourage the two large transit agencies in Cairo to switch from older diesel-fueled buses to new low-emissions buses. Together the two transit fleets operate more than 3,500 diesel buses. This could be a big benefit to the local bus manufacturers.

A10. Information technology

Information technology brings advances to business, financial services, agriculture, government, education, tourism, and society in general. The implications for Egypt of an improved IT sector are broad reaching and profound. More fundamentally, to compete in the world economy, advanced information technology infrastructure and services is critical to success. It both drives and supports economic growth.

The IT sector in Egypt has way underperformed compared to projections made by government and private sources in the late 1990s. Most recently, however, it has profited from steady growth over the last three years despite economic trouble in the rest of the country's economy. This seems to be the result of a focused effort by President Mubarak and the Government of Egypt (GOE) to advance the sector. Some results are shown in the table below.

Part of Egypt's strategy for developing the IT industry is to promote IT skills education. Egypt is creating over one thousand new computer science graduates annually (http://www.expolink.org.eg/Software_e.htm). In 2002, Microsoft Corporation signed an agreement with Raya Holding, an Egyptian information technology firm, to set up a privately owned academy providing high-level technical training to Egyptian software engineers. However, there remains a concern among those in the IT industries that these graduates can and do easily find work abroad in places like Dubai (Quasay Interview).

While students are being trained in IT, companies complain that the graduates lack sufficient training in certain areas. There are efforts underway working on this problem. The Ministry of Communications and Information Technology (MCIT) has initiatives for training three to five thousand IT specialists per year. In January 2004, the Cabinet Information and Support Centre (CIDSC) signed a protocol with Misr University to advise the university on IT course structure and content.

Egypt must currently rely on foreign technologies for all growth in IT infrastructure. The United States supplies over three quarters of all Egyptian IT imports. IT also represents nearly two fifths of Egyptian imports from the U.S. (U.S. Dept. Of Commerce, Country Commercial Guide Egypt 2002).

To encourage the development of IT industry, Smart Village and City Stars have been created. The Ministry of Communications and Information Technology told all major IT companies to relocate there within 3 years or be blacklisted. *[check this]* Locating companies in clusters is intended to increase networking and marketing collaboration which can be very helpful when competing in world markets. *[expand]*

Smart Village aims to provide a high-tech working environment for information technology companies. Firms have 53 plots and all companies that locate there will receive the tax holidays and other benefits of Law 8. When it opened in June 2002, there were 12 companies and they planned to invest E£420m in building and facilities. *[Update with number of companies now]*

While there are tax and tariff advantages for an IT company to be located in Smart Village and City Stars, there are other advantages to being in a free trade zone, including no tariffs paid on inputs and the right to have 100 percent foreign ownership of the company.

This is a sector where entrepreneurs will add dramatically to growth. Many entrepreneurs have worked previously abroad or in large local companies. Financing is a problem because new companies do not have a credit record and bankable collateral *[add what entrepreneurs need to be able to build businesses with export potential]*

Businesses in the IT sector can be classified into three categories: hardware, software, and services. *[Get definition for channels and professionals]*

2003	Revenue $ millions	Revenue £ millions	Revenue growth from prior year	Number of Companies	Number of Employees
IT Hardware	354	1,428	5.7%	40	330
IT Software	160	644	13.2%	84	727
IT Services	387	1,560	18.8%	95	925
Channels				514	5,249
IT Professionals					31,022
Total IT	902	3,633	12.3%	733	38,253

SOURCE: International Data Corporation (IDC) 2003.

Hardware has the second largest share of the IT market in Egypt and is a critical element in all IT business. The IT services subsector claims the largest portion of the IT market and is expected to play a big role not only in IT but also in overall growth of the Egyptian economy. Currently capturing 15 percent of the IT market, packaged software holds a great deal of potential for future IT export strength.

A. HARDWARE

The Hardware subsector can be divided into two major categories of products: Servers or Multi User Systems (MUS), and PC's and Workstations or Single User Systems (SUS). *[Current info suggests that all electronic hardware is imported with the exception of PC's assembled in Egypt. What components, if any are being manufactured in Egypt? Are any MUSs being assembled in Egypt? AmCham BSAC IT, 2002 gives conflicting data: Y2K ICT imports = $1.6B p.119, total ICT market in Y2K = $730m p.35]*

PC sales dominate this subsector and can be expected to drive its future growth. Egypt already claims the second highest growth in the world in PC sales (AmCham BSAC 2002, 67). *[check this, is it still true today?]* With approximately [1.2] million PCs installed in Egypt and an order for one million more by the MITC for distribution to university students we can expect significant growth in this sub sector (AmCham BSAC 2002, 72).

In 2000, Compaq and IBM were the leading foreign suppliers of PCs. *[Update]*

Local PC manufacturers, including Optics and Banha (a military factory), Nile PC, AlphaStar Egypt Co., International Electronics (subsidiary of Bahgat Group) and Ebony, *[check that the last 3 are Egyptian manufacturers] [How many local PC producing companies are there? What percent of market do they represent? What is the average production for each per month? This info. is available from International Data Corporation.]* accounted for approximately 68 percent of PC sales in 2000, totaling 111,838 units. As of 2002, locally assembled PCs were nearly 40 percent less expensive than their imported equivalent *[This may have changed since the E£ devalued. Explain the change.],* making them very attractive to the small office/home office and small and medium-size enterprise (SME) markets.

Because a large portion of users will continue to seek low-priced PCs, local assemblers offering inferior quality products will dominate the market and keep domestic standards low. *[Is this true?] [A more recent source said that hardware assembly companies have disappeared. Is this true?]*

These local companies benefit from tariff based advantages as well as corporate tax holidays of 5 or 10 years. "Imported computer products are subject to a total of 23 percent in taxes and tariffs, compared to 15 percent for locally assembled PCs" (http://www.amcham.org.eg/ publications/businessmonthly/February percent2000/Reports(ThreeMenAndAChip).asp

{Missing a comprehensive explanation of the source of Egypt's competitive advantage in the local PC assembly market. Can we get a distribution of size in Egyptian PC assembly companies?]

Margins in this market are rather low due to both a large population of SME's addressing this market locally as well as well-marketed MNCs. Elimination or reduction of tariffs in this subsector could deal a strong blow to the local PC assembly industry. Alternatively, it may stimulate the industry to consolidate buying power and further vertical integration. One critical hurdle facing the local PC industry is a lack of trust in technology and little perceived value. As PC proliferation and education increase, acceptance will increase.

Should the local PC industry be stunted at this time by stronger import options, they might never overcome that hurdle or compete competently in the market. *[Is this true? Explain.]*

The strengths of the personal computer market are low customs tariffs and a growing customer base. *[Is this still true? Are there other strengths?]*

The weaknesses are:

- Lack of financial support from banks since they charge high interest rates on loans financing IT activities.
- A shortage of large-scale local manufacturers that can supply the market with quality, cost-effective products to compete with international brands.
- Local manufacturers cannot take advantage of negotiating lower prices for components that come from placing large-volume orders.
- Because a large portion of buyers will continue to seek low-priced PCs, local assemblers offering inferior quality products will dominate the market and keep domestic standards low.

B. SERVICES

The services subsector can be sub-divided into five service areas: IT consulting, support services, operations management, implementation, and training. As Egyptian companies are required to compete in a global economy, demand for IT services will greatly increase.

Growth can be attributed to four main factors:

1. Improvements in the telecommunications network by Telecom Egypt – renewing and developing switching and transmission facilities, renewing the local network using digital microwave links;
2. Strong human resources – academic education through the expansion of computer studies and professional training programs;
3. Growth of high-tech communities – professional IT environments that offer companies better access to infrastructure and synergies with other IT companies (e.g. Smart Village project); and
4. More government officials devoted to IT promotion." (Assessment of Trade in Computer Services…GATS, 2004)

In 2002, the total revenue of all the companies providing computer services was approximately $326 million (ATCS…GATS, 2004). Because it is a relatively new and low-barriers-to-entry business sector, most companies are very small with less than $2 million capital and fewer than 50 employees. Of the 500 companies in the IT services sector, 440 (88 percent) are Egyptian companies selling locally, most of which have capital from $150,000 to $1.5 million. A few Egyptian companies (e.g. Raya, Orascom, Giza System) employ more than 200 people or have capital investment exceeding $10 million. A few multinational companies (e.g., IBM, ICL (Fujitsu), Microsoft, HP) operate in Egypt with capital exceeding $20 million and more than 100 employees.

The sector can also be characterized by the level of technological sophistication of the services provided. The most sophisticated computer services providers tend to work for large companies and multinationals with more than 100 computer users. About 10 percent (50) of Egyptian computers services companies are in this category, but they generate about 40 percent of the revenues. The cost of these services tend to be the highest because of the level of technical knowledge required and customers are not price sensitive. They are willing to pay well for high quality work and the amounts spent on IT consulting is a small percentage of their total expenses.

The next tier provides medium-priced, somewhat less sophisticated services primarily to small to medium-sized companies with 10 to 100 users. Major players in this segment are medium-sized local companies, mostly with technical support from multinational firms such as Microsoft and IBM.

The lowest tier consists of small Egyptian companies, formal and informal, whose customers are small businesses with fewer than 10 computer users and individuals. This customer group is very sensitive to the price of computer services. Their IT needs tend to be fairly simple as in off-the-shelf business application software, small networks and internet access. About 60 percent of computer services providers fall into this category but they only generate 35 percent of the category's annual revenue." (Assessment of Trade in Computer Services…GATS, 2004)

The strength of the services industry relies on a broad base of qualified personnel. Though a number of public and private sector projects have boosted IT personnel education, higher paying jobs in foreign IT markets continue to draw down the number of available IT professionals in Egypt. *[Insert findings on MENA IT pro. Mobility].* On the other hand, recent declines in the strength of American and European IT markets have brought many highly trained IT professionals back to Egypt. *[source?]*

Egyptian companies have the opportunity to take Arabic data-entry business from Dubai and Jordan where labor and other costs of doing business are significantly higher. *[check this and get specific details]*

C. SOFTWARE

The packaged software subsector has three categories: application solutions, application tools, and systems infrastructure. Applications solutions, which represented over half of the software subsector revenues, describe software products that serve end users in personal and corporate environments. Egyptian companies can do software development for clients in other countries by getting the flowcharts over the internet, creating the final code, and returning the final product via the internet. *[Get and insert most recent IDC pie chart of the Egyptian Packaged Software Industry from www.citegypt.com/images/SOFTIND]*

According to software experts, Egypt has tremendous potential in the domain of localization, customization, and consulting. Localization consists of adapting an existing software product to the Arabic language and to customs in the Arabic and Middle Eastern countries to give a local "look-and-feel."

Egypt's comparative advantages are: Arab countries pay licenses *[have to check what this means]* and there is a well trained labor force that is lower cost than Dubai or Jordan (the other prominent Arab IT development nations).

The strengths of the Egyptian software industry are: *[are these true? Are there others?]*

- Growing demand from large-scale projects in the financial sector, telecommunications, energy, manufacturing as well as increasing the level of automation in the government.
- A young, educated labor force along with the low cost of labor results in the ability to offer cost-effective packages at competitive prices.
- Egypt's strategic location is recognized as the gateway to the Arab and African markets and its time zone can provide North America with a second work shift.
- Majority of software developers have knowledge of English and Arabic.
- A high-speed communications network.
- Investment incentives and tax exemptions.

The weaknesses of the Egyptian software industry are: *[are these true? Are there others?]*

- Lack of business development services such as marketing and sales.

- Shortage of IT graduates with managerial and entrepreneurial skills.
- Weak software demand due to limited awareness of the importance of software and IT-related products in business development.
- Lack of financial schemes that support start-up software companies.
- Relatively high piracy rate.
- Lack of budgets to continue investing in research and development to improve applications.

Opportunities of the Egyptian software industry are: *[are these true? Are there others?]*

- The creation of the Pyramids Smart Village will provide "cluster" benefits of infrastructure, net-working potential, improved services, etc.
- The Software Export Development Organization responsible for promoting software exports and assisting developers to market their products globally.
- Implementing training programs will increase the number of qualified software developers.
- Creating the appropriate legislative environment by the government to encourage foreign direct investment in the sector.
- Attracting international companies interested in subcontract programming of tailored applications.
- Providing cultural content for the Middle East and North Africa.
- The introduction of the "Unicode Technology" making software useable in multiple languages which has become the common standard for all computer and software companies is expected to increase the demand for Arabic software.

Threats to the Egyptian software industry are: *[are these true? Are there others?]*

- Severe competition from mature software producing countries like Turkey, Israel, Ireland, Dubai, and Jordan.
- Most local software companies are relatively small to complete globally.
- The widening supply gap in well-trained personnel due to the brain drain to countries paying high wages.
- Continuation of limited demand for software.

Application tools, a critical ingredient to the growth of the packaged software industry, consists of those software packages used for software development. System infrastructure, the least represented category in the packaged software industry, describes those software products that create an environment within which application solutions and tools operate.

Obstacles currently moderating growth in this subsector include weak marketing, poor enforcement in the legal environment, a shortage of available personnel in certain key skills, and a scarcity of initial investment capital for startup businesses.

Egyptian software companies wishing to penetrate the U.S. market are faced with minimum marketing budgets of US$50 million (AmCham BSAC 2002, 54). However, MENA markets are quite accessible through Egypt's membership in COMESA and GAFTA. Specifically, Egypt is well positioned in the Arabic software applications space where they have supplied as much as 70 percent of the market in the Gulf region (Egyptian Exports Association (Expolink), GITEX 1999). *[Is this true?]*

Piracy is a problem. An Egyptian software company produced and sold various educational products on CDs. The products were introduced to the market, sold 5,000 copies and then there were no more sales. One of the products consisted of 4 levels each selling for $100. Six months later, the manager was visiting another country where he saw this product on sale for less than 10 percent of the original price.

According to the Business Software Alliance (BSA), a private industry trade group, software piracy in Egypt has decreased considerably over the past few years. Software piracy fell to 52 percent in 2002, meaning that roughly one out of every 2 pieces of software installed in 2002 were copied illegally. This percentage is down from 58 percent in 2001 and 88 percent in 1996. At the root of the problem is the practice of local PC assemblers to install pirated software. Sixty percent of hardware assemblers load the hard disk of new computers with copied software. Overall, Egypt's rate of piracy is slightly lower than the average for the Middle East. However, the BSA claims that US$15.5 million of software revenue was lost to piracy in 2002.

The BSA attributes the reduction in 2002 to successful government efforts to combat software piracy in the public sector in an attempt to comply with the TRIPS/WTO agreement. The BSA also claims that agreements between Microsoft and the ministries of higher education and telecommunications allowing students and government departments to purchase original software at reduced prices has contributed to the reduction.

Authority over business and entertainment software copyright has moved to the Ministry of Communications and Information Technology and it is expected that enforcement against all forms of piracy will improve. Within the Ministry of the Interior, the Computer Crimes Unit (CCU) has commenced raiding. The CCU has demonstrated its knowledge of difficult copyright and technical computer issues. However, the Ministry of Culture and the Anti-Piracy Unit of the police department remain largely uninterested in enforcement against piracy. The ministry took very few actions against pirates in 2002, despite the many violators in Egypt. None of the actions taken by the business software industry through the ministry in 2002 resulted in deterrent fines or sentences.

In 2003, Egypt's software exports were $ _____ with _____, _____, and _____ being the major markets.

To export products, must be ISO compliant.

Under Law 8 of 1997 *(What is Law 8?)*, companies producing computer software and systems have various tax exemptions as well as a tariff of 5 percent on imported machinery, equipment, and instruments, which would otherwise be 5 percent-40 percent.

Imports of U.S. software into Egypt amounted to _____in 2002. Many of these products have no effective domestic competition. However, _____ in tariffs were levied on these products.

"Most tariffs on IT products in Egypt will be zero by 2005 and all of them will reach zero by 2007. The elimination of tariffs should help lower the cost of IT technology and enable more individual Egyptians to have access to computers which in turn will stimulate growth in the local software and services segments." (Assessment of Trade in Computer Services in Egypt in Relation to the GATS, 2004, p.7).

Institute for Microsoft software and Intel…*[need info. on this].*

D. INTERNET SERVICES (WHERE DOES THIS FIT INTO THE EARLIER TABLE?)

The diffusion of the Internet throughout Egypt has been an important catalyst for boosting sales of hardware, software, and services, but it has been at too slow a rate to place Egypt on equal footing with developed countries.

As of September 2001, there were 70,000 Internet subscribers in Egypt. (Source: www.ajeeb.com) *[update the figures]* Assuming 8 users per account, the number of Internet users was 560,000 or less than 1 percent of the population.

In October 2001, a partnership between LINKdotNET, the largest private Internet Service Provider in Egypt and Microsoft launched the Arabiamsn.com. portal to promote Arabic content on the web. The site was launched in Dubai *[why not Egypt??]* to be the Arab world's and the Middle East's first global portal. Since then, *[add what has developed since then].*

Egypt might benefit from creating a Business-to-Business Internet marketplace similar to Tejari.com. Initiated in June 2000, by the Dubai Ports Authority and supported by the Government of Dubai, the business portal allows companies to trade goods and services over the Internet and implement transactions online using any purchasing method, including spot buying, reverse auctioning, and company-specific catalog purchases. Tejari.com allows companies to access new markets and eventually increase revenues, reduce costs, and increase time efficiency. The portal was ranked as the Middle East's premier online exchange by Oracle Corporation, one of the largest providers of software for e-business. In 2002, there were more than 60 trading partners using the portal to list over 60,000 items including computer equipment, office suppliers automotive parts, and pharmaceuticals. *[check to see whether Tejari.com is growing. If so, check whether Egypt has something similar to it. Any other observations of the Tejari.com model?]*

On the policy front, protection of personal data remains of paramount concern as countries learn how to address the vulnerability of personal and business data. In addition, businesses, government, and individuals all are examining security. Egypt will have to establish some laws and systems to deal with Internet and network threats.

Egyptian companies seem to have a problem with individual e-business consumers of perceived untrustworthiness. There is a reluctance to give credit card information to an Egyptian company.[37] This limits the potential of Egyptian companies to sell their products using this global marketing/distribution vehicle. This problem may be caused by Egypt's lack of laws protecting e-purchases or e-signatures. *[Expand.]*

[Need more description of the Internet subsector in Egypt.]

There is an important problem facing Egyptian companies and other Arab companies wanting to provide Internet services to companies or individuals in other Arab countries. There is no Internet backbone linking Arab countries. *[check this]* Most Arab countries have their technical backbone link to the United States so messages going from an Arab country to a neighboring Arab country travel to the United States and back with the associated time delay. This has led some companies to have their hosting servers in the United States There is also a political reason behind this choice of location. In some Arab countries the contents of the website might be illegal [give an example] and it could be closed down.

E. WTO COMMITMENTS

Egypt's commitments in information technology are described in the Agreement on Information Technology (AIT) under GATT. Computer services are not subject to tariffs or custom duties, but computers and computer parts are, and these tariffs are to be eliminated under the Agreement. Tariffs represent about 3 percent of the total cost of computer services. The cost of imported inputs is 20 percent of total cost, with an average tariff rate of 15 percent (2002). According to the WTO Information Technology Agreement, to which Egypt is now a party, Egypt is committed to reaching zero tariff on the bulk of IT goods by 2005 and on all its IT goods by 2007.

IT is closely linked with telecommunications. Egypt became a member of the WTO Basic Telecommunication Agreement in 2002. However, because the IT sector is already open, vibrant, and economically healthy, no immediate substantial economic impact, positive or

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[37] For example, an Egyptian company markets its product over the internet as a subscription service. It was their experience that customers would be hesitant to give their credit card information to an Egyptian company. So it was decided to use a U.S. company to be the payment gateway and guarantee to the customer that he/she is not charged until the service is delivered. Two American payment gateway companies, WorldPay and PayPal refused to provide their services to an Egyptian company. *[Check with them.]* The Egyptian company had one of two choices: process the payments themselves or work through an intermediary U.S. company that would contract the U.S. payment gateway company. The latter was chosen and it works well except that there is a decline in quality of customer service caused by the delay in responding to requests as they go through the intermediary and then are channeled to the Egyptian company. There is also a significant increase in cost, a 10% fee based on revenues charged by the intermediary.

negative, is expected. In the long term, the inflow of capital from Egypt's GATS commitment in telecommunications could help the IT sector. Liberalizing the information and communications technology sector in general should create an environment that will attract foreign direct investment. In the long term, the influx of capital that will come when investors are assured of Egypt's international legal commitment should help the sector.

There will be no major legal changes for Egypt under the existing AIT, GATS, and Basic Telecommunications Agreement commitments. Investment, temporary entry, and tax restrictions can be, and have been, maintained. Restrictions in Egyptian law, such as the requirement that 49 percent of shareholders be Egyptian, apply across the board to all services industries. In addition, ministers can apply limitations on the number of natural persons entering the country. These horizontal legal issues aside, there are no sector-specific legal impediments to trade in computer services. Therefore, a binding commitment to computer services in a GATS schedule of commitments would simply ensure that the existing open, liberal situation is sustained. Commitments would provide trading partners with the assurance that investments made in this sector in Egypt will be protected.

A commitment positions Egypt to negotiate legally binding commitments from its trading partners in this area, thus helping the computer services industry export to other markets. In making this legally binding obligation, Egypt is better positioned to ensure its trading partners do the same. This provides Egyptian industry with the legal assurance that investments made in foreign markets will be respected. It ensures that barriers to entry are removed and Egyptian companies can compete better.

Appendix B. Egypt's Trade with the EU, United States, Middle East, and SACU

Table B-1

Value of Egypt's Exports 2002 and Growth of Exports 1998-2002 to the EU, US, Middle East, and SACU (value in $US '000; growth in % per annum)

Product Code	Product Label	Value to EU	Growth to EU	Value to US	Growth to US	Value to Mid East	Growth to Mid East	Value to SACU	Growth to SACU
	All products	2,525,751	9	1,416,613	19	592,339	-10	27,832	
1	Live animals	641	-10	156	3	579	-2	0	
2	Meat and edible meat offal	0		0		935		0	
3	Fish, crustaceans, mollusks, aquatic invertebrates nes	268	6	16		2,507	16	0	
4	Dairy products, eggs, honey, edible animal product nes	181	-4	440	29	13,214	44	21	
5	Products of animal origin, nes	7,464	0	739	89	0		0	
6	Live trees, plants, bulbs, roots, cut flowers etc	3,494	26	176	11	1,221	35	0	
7	Edible vegetables and certain roots and tubers	74,525	1	3,241	14	29,387	4	123	
8	Edible fruit, nuts, peel of citrus fruit, melons	28,226	26	351		50,511	5	596	
9	Coffee, tea, mate and spices	2,068	7	4,047	8	7,767	40	98	
10	Cereals	3,189	16	66	-11	43,669	-8	0	
11	Milling products, malt, starches, inulin, wheat gluten	33	0	0		316	52	0	
12	Oil seed, oleagic fruits, grain, seed, fruit, etc, nes	11,033	5	6,099	8	4,976		43	
13	Lac, gums, resins, vegetable saps and extracts nes	0		0		73	-1	0	
14	Vegetable plaiting materials, vegetable products nes	90	16	36	-27	113	6	0	
15	Animal,vegetable fats and oils, cleavage products, etc	419	37	205	43	2,566	57	240	
16	Meat, fish and seafood food preparations nes	78	-26	0		245	-9	0	

Product Code	Product Label	Value to EU	Growth to EU	Value to US	Growth to US	Value to Mid East	Growth to Mid East	Value to SACU	Growth to SACU
17	Sugars and sugar confectionery	18,883	6	2,347	31	6,893	7	254	
18	Cocoa and cocoa preparations	30		154		884	-13	209	
19	Cereal, flour, starch, milk preparations and products	84	6	951	156	1,633	-16	107	
20	Vegetable, fruit, nut, etc food preparations	2,538	29	6,579	16	11,103	6	167	
21	Miscellaneous edible preparations	207	-26	679	53	25,487	-9	10	
22	Beverages, spirits and vinegar	2,543	31	194	19	1,701	24	0	
23	Residues, wastes of food industry, animal fodder	10,284	23	0		772	215	0	
24	Tobacco and manufactured tobacco substitutes	12	-2	690	4	7,945	-7	322	
25	Salt, sulphur, earth, stone, plaster, lime and cement	25,526	16	2,355	31	7,591	5	16	
26	Ores, slag and ash	2,051	26	0		37	9	0	
27	Mineral fuels, oils, distillation products, etc	1,167,055	9	218,818	45	41,483	-42	1,543	
28	Inorganic chemicals, precious metal compound, isotopes	43,110	32	24,934	302	20,232	12	33	
29	Organic chemicals	4,641	3	47	-21	2,604	10	29	
30	Pharmaceutical products	1,955	11	0		18,087	-6	90	13
31	Fertilizers	83,654	55	13,524	24	7,262	7	3,099	
32	Tanning, dyeing extracts, tannins, derivs,pigments etc	674	4	0		921	4	134	
33	Essential oils, perfumes, cosmetics, toileteries	13,475	-3	1,491	-5	5,906		335	
34	Soaps, lubricants, waxes, candles, modelling pastes	584	10	0		5,646	83	1,376	
35	Albuminoids, modified starches, glues, enzymes	16	-34	36		207	7	0	
36	Explosives, pyrotechnics, matches, pyrophorics, etc	169	5	0		326		13	

Product Code	Product Label	Value to EU	Growth to EU	Value to US	Growth to US	Value to Mid East	Growth to Mid East	Value to SACU	Growth to SACU
37	Photographic or cinematographic goods	0		0		243		0	
38	Miscellaneous chemical products	1,761	-35	93		12,073	10	3,047	
39	Plastics and articles thereof	42,477	28	1,515	16	11,863	2	463	
40	Rubber and articles thereof	6,707	7	89	38	4,441	9	225	40
41	Raw hides and skins (other than furskins) and leather	57,479	55	0		1,234	-18	0	
42	Articles of leather, animal gut, harness, travel goods	702	-1	249	16	321	-8	42	
43	Furskins and artificial fur, manufactures thereof	13	-6	0		0		0	
44	Wood and articles of wood, wood charcoal	281	-11	287	-8	2,373	-6	0	
46	Manufactures of plaiting material, basketwork, etc.	86	1	0		114	-12	0	
47	Pulp of wood, fibrous cellulosic material, waste etc	0		0		86		102	
48	Paper & paperboard, articles of pulp, paper and board	3,945	-15	102	16	5,001	-2	708	
49	Printed books, newspapers, pictures etc	1,915	3	791	51	4,235	9	11	
50	Silk	0		0		66		46	
51	Wool, animal hair, horsehair yarn and fabric thereof	144	-5	0		100	13	0	
52	Cotton	136,426	-9	54,953	1	26,769	-14	1,203	
53	Vegetable textile fibres nes, paper yarn, woven fabric	6,491	5	53		243	2	0	
54	Manmade filaments	13,511	3	2,044	-7	500	-39	0	
55	Manmade staple fibres	8,645	1	1,092	46	4,644		0	
56	Wadding, felt, nonwovens, yarns, twine, cordage, etc	5,738	124	42	59	464	-4	0	
57	Carpets and other textile floor coverings	27,378	9	59,645	13	1,394	3	963	

Product Code	Product Label	Value to EU	Growth to EU	Value to US	Growth to US	Value to Mid East	Growth to Mid East	Value to SACU	Growth to SACU
58	Special woven or tufted fabric, lace, tapestry etc	762	-6	846	8	552	10	24	
59	Impregnated, coated or laminated textile fabric	185	-8	0		5,326	130	0	
60	Knitted or crocheted fabric	1,250	19	290	221	345	-18	10	
61	Articles of apparel, accessories, knit or crochet	167,078	11	140,255	-5	2,405	-6	28	
62	Articles of apparel, accessories, not knit or crochet	54,072	-9	229,483	6	4,317	0	53	
63	Other made textile articles, sets, worn clothing etc	62,231	0	32,231	14	3,780	6	84	
64	Footwear, gaiters and the like, parts thereof	7,571	24	155	10	572	-24	29	
65	Headgear and parts thereof	587	2	18	-40	17	10	0	
66	Umbrellas, walking-sticks, seat-sticks, whips, etc	0		0		23	161	0	
68	Stone, plaster, cement, asbestos, mica, etc articles	2,653	35	2,357	21	4,172	60	453	
69	Ceramic products	21,256	4	336	-2	10,464	43	3,733	67
70	Glass and glassware	2,203	-1	1,580	-16	3,102	-2	134	
71	Pearls, precious stones, metals, coins, etc	2,558	1	531	-4	98	-13	0	
72	Iron and steel	73,523	37	104,539	51	42,635	1	370	
73	Articles of iron or steel	6,753	9	2,119	-2	9,474		450	
74	Copper and articles thereof	987	40	381	15	9,468		0	
75	Nickel and articles thereof	73	20	0		23		0	
76	Aluminium and articles thereof	129,613	19	1,448	-32	20,498		52	-21
78	Lead and articles thereof	954		0		0		0	
79	Zinc and articles thereof	0		0		45	30	0	
80	Tin and articles thereof					0		0	

Product Code	Product Label	Value to EU	Growth to EU	Value to US	Growth to US	Value to Mid East	Growth to Mid East	Value to SACU	Growth to SACU
81	Other base metals, cermets, articles thereof	17	-17	0		101	7	0	
82	Tools, implements, cutlery, etc of base metal	671	-29	3,279	-3	879	-33	30	-23
83	Miscellaneous articles of base metal	1,384	58	484	37	494	-8	21	
84	Nuclear reactors, boilers, machinery, etc	48,722	-5	1,920	2	24,997	3	2,557	
85	Electrical, electronic equipment	54,687	26	971	10	16,365		2,243	64
86	Railway, tramway locomotives, rolling stock, equipment	101	-9	0		0		0	
87	Vehicles other than railway, tramway	1,561	-12	45	47	3,770		662	
88	Aircraft, spacecraft, and parts thereof	238	-60	0		0		0	
89	Ships, boats and other floating structures	5,090	210	0		18		0	
90	Optical, photo, technical, medical, etc apparatus	17,110	8	414	5	3,758	-4	582	
91	Clocks and watches and parts thereof	11	-32	44	-8	0		0	
92	Musical instruments, parts and accessories	95	-11	29	-19	260	3	0	
93	Arms and ammunition, parts and accessories thereof	0		0		0		0	
94	Furniture, lighting, signs, prefabricated buildings	14,543	3	21,807	-2	9,392	16	344	330
95	Toys, games, sports requisites	195	-20	1,411	45	215	-5	15	
96	Miscellaneous manufactured articles	1,732	-2	1,600	18	1,963	-4	188	
97	Works of art, collectors pieces and antiques	514	13	7,854	-10	39	-9	0	
98	Commodities specified at chapter level only	16,173				0		0	
99	Commodities not elsewhere specified	5,407	7	450,808	65	11,619		14	

SOURCE: *International Trade Centre, TradeMap*

Table B-2

Value of Egypt's Imports 2002 and Growth of Imports 1998-2002 from the EU, US, Middle East, and SACU (value in $US '000; growth in % per annum)

Product Code	Product Label	Value from EU	Growth from EU	Value from US	Growth from US	Value from Mid East	Growth from Mid East	Value from SACU	Growth from SACU
	All products	5,700,079	-10	2,810,095	1	698,186		21,265	
1	Live animals	6,899	-21	3,585	-15	0		86	
2	Meat and edible meat offal	193	-82	22,761	-12	173		0	
3	Fish, crustaceans, molluscs, aquatic invertebrates nes	48,545	1	0		82		0	
4	Dairy products, eggs, honey, edible animal product nes	65,866	-7	781	-48	29	-20	0	
5	Products of animal origin, nes	1,144	-22	452	17	369		0	
6	Live trees, plants, bulbs, roots, cut flowers etc	1,862	22	0		57	-5	158	
7	Edible vegetables and certain roots and tubers	44,747	4	473	-39	21,958	-15	0	
8	Edible fruit, nuts, peel of citrus fruit, melons	3,370	17	8,819	1	18,521	-5	100	
9	Coffee, tea, mate and spices	1,511	-8	77	47	7,392		106	
10	Cereals	209,272	15	636,913	-2	4,632		76	
11	Milling products, malt, starches, inulin, wheat gluten	7,054	-16	1,517	-36	1,290	-15	14	
12	Oil seed, oleagic fruits, grain, seed, fruit, etc, nes	7,958	13	38,456	23	2,892		33	
13	Lac, gums, resins, vegetable saps and extracts nes	3,713	8	116	-4	57	181	0	
14	Vegetable plaiting materials, vegetable products nes	15		30		579		0	

Product Code	Product Label	Value from EU	Growth from EU	Value from US	Growth from US	Value from Mid East	Growth from Mid East	Value from SACU	Growth from SACU
15	Animal,vegetable fats and oils, cleavage products, etc	11,757	-23	43,212	-11	4,654		0	
16	Meat, fish and seafood food preparations nes	3,159	-1	5,164	220	173	47	124	
17	Sugars and sugar confectionery	23,861	-9	1,066	-8	2,247	62	228	
18	Cocoa and cocoa preparations	8,639	6	254	-3	314	41	124	
19	Cereal, flour, starch, milk preparations and products	18,581	-3	490	-8	556	22	45	
20	Vegetable, fruit, nut, etc food preparations	4,486	-16	335	-17	5,976		82	
21	Miscellaneous edible preparations	29,910	4	2,189	-18	2,963	19	15	
22	Beverages, spirits and vinegar	11,102	-9	437	1	0		67	
23	Residues, wastes of food industry, animal fodder	13,723	-38	89,990	32	4,480	56	104	
24	Tobacco and manufactured tobacco substitutes	33,173	-7	3,069	-65	392	-6	1,286	
25	Salt, sulphur, earth, stone, plaster, lime and cement	25,292	-13	1,952	1	5,030	-27	1,192	
26	Ores, slag and ash	22,067	-9	0		41		306	
27	Mineral fuels, oils, distillation products, etc	47,849	-14	41,319	2	262,475		165	
28	Inorganic chemicals, precious metal compound, isotopes	20,321	-2	29,650	105	5,097	0	1,568	
29	Organic chemicals	234,957	2	31,180	3	5,798	52	3,156	
30	Pharmaceutical products	275,828	5	22,477	13	2,579	-11	77	
31	Fertilizers	13,982	10			4,488	-4	0	

Product Code	Product Label	Value from EU	Growth from EU	Value from US	Growth from US	Value from Mid East	Growth from Mid East	Value from SACU	Growth from SACU
32	Tanning, dyeing extracts, tannins, derivs,pigments etc	105,994	-6	15,531	25	3,612	7	218	
33	Essential oils, perfumes, cosmetics, toileteries	59,423	-4	5,252	-3	274	6	0	
34	Soaps, lubricants, waxes, candles, modelling pastes	32,483	-1	3,171	-12	8,036	-4	70	
35	Albuminoids, modified starches, glues, enzymes	18,985	1	2,134	9	515		0	
36	Explosives, pyrotechnics, matches, pyrophorics, etc	2,025	-11	1,855	-24	189	24	97	
37	Photographic or cinematographic goods	18,835	-7	250	-37	12	9	32	
38	Miscellaneous chemical products	157,839	-1	12,266	-17	8,295	27	1,701	
39	Plastics and articles thereof	252,070	0	67,569	14	34,658	14	657	
40	Rubber and articles thereof	44,554	-10	4,435	19	7,496	-13	496	
41	Raw hides and skins (other than furskins) and leather	1,370	8	0		0		0	
42	Articles of leather, animal gut, harness, travel goods	1,978	-10	338	30	107	-18	0	
43	Furskins and artificial fur, manufactures thereof	82	-17	694	52	0		0	
44	Wood and articles of wood, wood charcoal	126,498	-14	6,705	-6	4,372	26	31	
45	Cork and articles of cork	768	20	59		554		0	
46	Manufactures of plaiting material, basketwork, etc.	0		0		0		0	
47	Pulp of wood, fibrous cellulosic material, waste etc	8,777	23	18,464	1	66		41	

Product Code	Product Label	Value from EU	Growth from EU	Value from US	Growth from US	Value from Mid East	Growth from Mid East	Value from SACU	Growth from SACU
48	Paper & paperboard, articles of pulp, paper and board	165,692	-2	24,846	-5	11,421	15	125	
49	Printed books, newspapers, pictures etc	23,022	-3	2,515	-9	1,132		0	
50	Silk	291	-1	0		0		0	
51	Wool, animal hair, horsehair yarn and fabric thereof	10,251	3	0		1,174	-22	0	
52	Cotton	18,317	0	39	-45	17,101		0	
53	Vegetable textile fibres nes, paper yarn, woven fabric	3,057	1	0		0		0	
54	Manmade filaments	21,302	-2	3,067	40	19,338	16	0	
55	Manmade staple fibres	22,880	-6	836	-44	3,035	-16	204	
56	Wadding, felt, nonwovens, yarns, twine, cordage, etc	5,928	-4	238	-7	2,278	8	0	
57	Carpets and other textile floor coverings	868	-21	245	-13	633	24	0	
58	Special woven or tufted fabric, lace, tapestry etc	5,359	8	692	27	981	0	0	
59	Impregnated, coated or laminated textile fabric	11,357	-7	604	-7	987	-14	0	
60	Knitted or crocheted fabric	6,458	19	33	16	1,671	23	0	
61	Articles of apparel, accessories, knit or crochet	6,886	-17	92	-46	1,069	-48	0	
62	Articles of apparel, accessories, not knit or crochet	16,176	-18	126	-8	14,818	-34	0	
63	Other made textile articles, sets, worn clothing etc	9,144	-4	275	22	1,213	0	90	

Product Code	Product Label	Value from EU	Growth from EU	Value from US	Growth from US	Value from Mid East	Growth from Mid East	Value from SACU	Growth from SACU
64	Footwear, gaiters and the like, parts thereof	11,214	-19	469	-12	530	-21	82	
65	Headgear and parts thereof	275	-1	47	4	0		0	
66	Umbrellas, walking-sticks, seat-sticks, whips, etc	813	88	0		0		0	
67	Bird skin, feathers, artificial flowers, human hair	94	-1	0		0		0	
68	Stone, plaster, cement, asbestos, mica, etc articles	26,674	-4	1,473	-24	1,557	-9	0	
69	Ceramic products	35,405	-6	1,190	9	1,340	25	0	
70	Glass and glassware	35,144	-4	4,049	6	12,420	-6	12	
71	Pearls, precious stones, metals, coins, etc	16,142	-3	95	-26	123	58	0	
72	Iron and steel	89,388	-10	8,123	-3	22,592	-23	2,432	
73	Articles of iron or steel	168,861	-18	22,250	1	20,320	-7	159	
74	Copper and articles thereof	22,653	-11	7,132	12	1,168	-13	196	
75	Nickel and articles thereof	2,050	-8	13	-46	0		0	
76	Aluminium and articles thereof	62,788	5	3,318	-14	3,212	6	0	
78	Lead and articles thereof	74	-43	0		0		0	
79	Zinc and articles thereof	1,599	-19	0		161	9	0	
80	Tin and articles thereof	789	-12	101	64	36	143	0	
81	Other base metals, cermets, articles thereof	566	-23	852	32	0		0	
82	Tools, implements, cutlery, etc of base metal	22,565	-12	5,801	0	125	-21	31	
83	Miscellaneous articles of base metal	24,560	-6	42,168	85	2,464	-4	0	

Product Code	Product Label	Value from EU	Growth from EU	Value from US	Growth from US	Value from Mid East	Growth from Mid East	Value from SACU	Growth from SACU
84	Nuclear reactors, boilers, machinery, etc	1,245,473	-13	350,319	-8	30,269	-3	3,606	
85	Electrical, electronic equipment	639,740	-14	160,720	-5	11,307	-6	895	
86	Railway, tramway locomotives, rolling stock, equipment	10,298	-39	5,803	-20	64	6	0	
87	Vehicles other than railway, tramway	227,865	-17	197,315	5	57,188	0	373	
88	Aircraft, spacecraft, and parts thereof	23,045	-18	559,416	34	0		0	
89	Ships, boats and other floating structures	8,202	12	1,460	-45	0		0	
90	Optical, photo, technical, medical, etc apparatus	237,448	-4	57,203	-8	1,328	4	425	
91	Clocks and watches and parts thereof	1,302	-17	206	-2	11	-5	0	
92	Musical instruments, parts and accessories	1,101	-1	412	41	0		0	
93	Arms and ammunition, parts and accessories thereof	4,246	18	144,817	-18	669	-26	0	
94	Furniture, lighting, signs, prefabricated buildings	35,952	-16	18,812	-12	1,437	4	44	
95	Toys, games, sports requisites	6,557	-13	2,300	-18	63	11	0	
96	Miscellaneous manufactured articles	13,423	-5	820	-21	439	-16	37	
97	Works of art, collectors pieces and antiques	752	-33	217	40	0		0	
98	Commodities specified at chapter level only	252,037	5	292		14,484	139	0	
99	Commodities not elsewhere specified	79,905	-14	53,790	3	4,431		21	

Source: International Trade Centre, TradeMap

Annex C. Persons and Organizations Contacted

Organization	Contact(s) Name	Title	Tel	Fax	e-mail	Mailing address
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Al-Ahram Economic Weekly	Shahira El Rafei	Managing Editor	7703808	5786833	ik@ahram.org.eg	Al-Ahram Building Algalaa St., Cairo
American Chamber of Commerce in Egypt	Hisham A. Fahmy	Executive Director	202-338-1050	202-338-1060	hfahmy@amcham.org.eg	33 Soliman Abaza St., Dokki 12311- Cairo
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Engineering Automotive Manufacturing Co.	Ahmed Barakat	Managing Director	202-3712273	2023701467		
Engineering Automotive Manufacturing Co.	Nabil Ibrahim Mohamed	marketing & export sector director	202-3692613	202-3701467		Wadi Hof - Helwan, Cairo
EnviroEgypt	Alla E. Ezz	Managing Direcor, CEO	2027486473	2027601223	ezztips@intouch.com	Mesaha Tower, 33a Haroun St. Dokki, Cairo
Esprit Holdings, Ltd.	Heinz Jurgen Krogner-Kornalik	Deputy Chairman and group CEO				Hong Kong
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Faragalla Group	Samy El-Awady Ghareeb	Representative of Chairman for External Relations	03-4592041	03-4593189		New Borg El-Arab City 1 St., Industrial Zone
Farm Frites	Tarek Z. Tawfik	Managing Director	202-5772100	2015-411470	ttawfik@farmfrites.com.eg	10th of Ramadan City. Third Industrial Zone A2 (Lot C)

Organization	Contact(s) Name	Title	Tel	Fax	e-mail	Mailing address
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Hesni Group	Marianne Hesni	CEO				Heliopolis, Cairo
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SINAI International for Marble and Granite	Nagui Taha	Export Manager	202-7541024-25-7541575	202-7541026	sinaimarble@sinaimarble.com	Shak El Soaaban Rd., Torah, Cairo
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United Company for Poultry/ Valigi Maamoun	Galal Maamoun		202-7617060	202-2168295	galalmmm@hotmail.com	2, Soliman Abaza St. El Mohandeseen, Cairo
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